MINISTRY OF FINANCE

FLASH REPORT

on

key features of economic processes and financial flows

(based on data for January-July 2003)

Budapest, 10 September 2003

CONTENTS

Flash Report
on main characteristics of economic processes and financial flows[1]
(based on data for January-July 2003)

Our analyses of any aspect of the national economy have been prepared on the basis of the most recent figures available. For the GDP as a whole and its components, there are only figures published from the first six months and quarter 1, respectively. Also, assessments of foreign trade, labour market developments and consumer prices are based on figures of January to July, while for investments, industrial production including constructions and wages, retail sales and balance of payments, figures of January to June are delivered. For general government sector, we have had numbers relevant to January to August while for details of deficit the figures are available from January to July.

1. International conditions

Economic recovery is uneven but has started

Based on the latest developments in the world economy, the second six months of 2003 may be a turning point while the recovery will not start at the same time in particular regions. The economic environment remained rather uncertain. The engine of recovery is first of all the American economy while the euro zone continues to be a "weak link". In the World Bank's latest forecasts, the world economy will grow by about 2 per cent and 3 per cent in 2003 and 2004, respectively.

The U.S. economy shows gradually clearer signs of economic recovery

In the **United States of America**, the developments of last summer are a cause of optimism. The stimulating economic policy, significant productivity gains, raising volume of exports promoted by the weak American Dollar, improving corporate and consumer confidence indices, further soaring of the property market, recovering stock markets are encouraging signs. The most recent figures of manufacturing industry also suggest that the American economy is to recover in the second six months, and expected to shift to the path of sustainable economic growth. However, as to the IMF analysis, the lack of job creation, the recent increase of long-term interest rates as well as ailing investments continue to slow the fast return on the potential growth path. The World Bank's forecasts are 2.2 per cent and 2.5 per cent for GDP growth in 2003 and 2004, respectively. Latest projections by OECD are brighter at 2.5 per cent of growth for 2003.

The Japanese economy performed better than expected

The **Japanese economic** performances outrun the earlier expectations. Risk factors influencing the growth rates for 2003 (1.5 per cent) and 2004 (1.3 per cent) as included in the European Commission's report published the last spring carry upside risks. Improving outlook for the main export markets as well as the newly-raising domestic demand are to make a positive impact. Preliminary estimates relevant the second quarter show that the Japanese GDP has now been growing for six years consecutively. However, it should be considered that the recovery was supported by one-off factors as well as the fact that the permanent structural inequalities (especially in the financial sector) carry downside risks. The OECD forecast is above 2 per cent for 2003 as a whole.

[1] The most important facts, macroeconomic projection and international information are contained in the Tables 1 to 4.

The euro zone economy is still ailing

The **euro zone** economy was in practice stagnating in the first six months of 2003. Following a GDP growth by 0.1 per cent in the first quarter, the growth made up 0.0 per cent in the second quarter based on preliminary data. The modest earlier growth was due to households' consumption, in addition to increasing government expenditures. Investments added –0.3 per cent to the quarterly growth rate. Foreign trade contribution to GDP growth was also negative due to a strengthened euro. Therefore, last quarter saw consumption as the driver of growth while in the future it is not likely to play this role because of the deteriorating labour market situation and lagging recovery of propensity to consume. Some figures, however, suggest slow improvement in the second half of 2003. The strong single currency contributes to disinflation; thus, disposable real income can grow faster than originally expected. More favourable international environment, lower interest rates, improved confidence indices of corporations and consumers, upsurge in the stock exchanges headed for this way. The principal factor of uncertainty is the time required for financial consolidation of corporate sector as a precondition of the expansion of business investments to start. In the European Commission's estimates, the economic growth of this year will average at about 0.5 per cent, while IMF analysts anticipate a growth of 0.7 and 1.7 per cent for 2003 and 2004, respectively. In the face of OECD's former forecast, signs of European recovery appeared some three months later but with fair clarity. First of all, it is the services sector to give a cause of confidence with expansion unseen for more than a year. With all this in view, the international organisation cut back their 2003 forecast of GDP growth to 0.5 per cent by 0.5 percentage point. However, 2004 projection is still at 2.4 per cent. Due partly to GDP growth slower than formerly projected, general government deficit may well exceed in most Member States the levels set by the stability and convergence programmes and those included in the Commission's most recent Spring Forecast. The difference is high in the major economies of the euro zone such as France, Germany and Italy in particular.

German economy near to stagnation in 2003

Four EMU Member States including **Germany** are in recession. The German economy was now shrinking in two consecutive quarters. First of all, it is the fall in trade to scale back growth while domestic demand seems to recover. Also, better confidence indices suggest improvement for the second half of the year.

External upturn in demand from the second six months at best

Foreign demand for **Hungarian** export was the lowest in 2002 (0.2 per cent). For 2003, a growth of 4.2 per cent can be expected, based on OECD springtime estimates. Due to the worse-than-expected positions across the EU region in the first six months, the increase in foreign demand is likely to be weaker than assumed by OECD since Hungarian exports are mostly destined for this region as reflected in the Hungarian export dynamics for 2003.[2]

[2] Import demand in Hungary's major 15 trade partners is to determine foreign demand for the country. The OECD's new autumn estimates are expected In October to November as updated on the final facts and figures for the performances in the first six months.

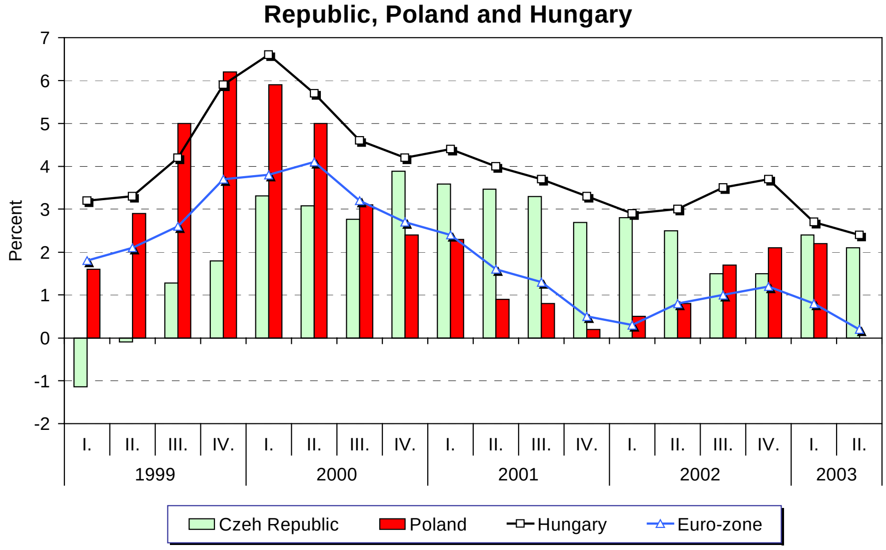
2. Economic growth

The GDP increased by 2.6 per cent in the first six months

Based on preliminary information by the Central Statistical Office, Gross Domestic Product went up by 2.4 per cent in the second quarter, well behind the analysts' expectations, lowering the growth rate for the first six months as a whole to 2.6 per cent. Based on the figures seasonally adjusted, a slight increase was seen in relation to the previous quarter, indicating even a possible change to trend. Any confirmation of this is yet to come from the next period.

The diminishing economic performances were continuously due to adverse conditions in foreign markets. Preliminary figures suggest that GDP growth of Hungary's major trade partners, especially the European economies, decelerated or even turned negative in certain countries. By international standards, the Hungarian economic growth is still considered high.

The quarterly GDP growth rate in Euro-zone, the Czeh Republic, Poland and Hungary

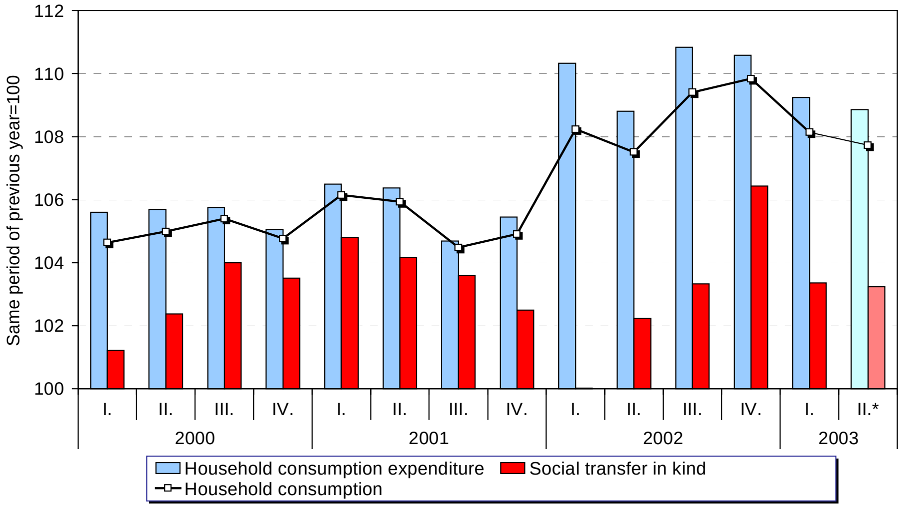


The composition of GDP further deteriorated in the first quarter. In particular, investments also fell while the unfavourable external economic environment were maintained. Thus, consumption remained alone the driving force of the GDP growth.

The consumption dynamics still well over that of GDP; only a slight moderation seen

As a result of continued and significant income outflow and declining financial savings in the first quarter, the households' consumption increased by more than 8 per cent. In the second quarter, this pace is estimated to somewhat mitigate, while the nature of the process remained the same. It can be derived only from the figures of wage outflow and retail sales both implying a fast but slowing increase. For the rest of the year, major deceleration of consumption dynamics is not expected either. What is more, even acceleration is likely in the fourth quarter because of VAT changes planned for 2004, pension for the 53rd week or benefit addition for the whole year and earnings supplement to child-care allowance to be paid. In the whole of 2003, households' consumption may therefore be still higher than forecasted by the Flash Report of June 2003. As a result, the growth rate is estimated to be between 7 and 8 per cent in this context.

Volume indices of household consumption



* Estimate

After the decline of first quarter, investments on a national economy basis started to grow in the second quarter. The composition of them also made a shift towards positive direction. Engineering investments largely – almost 11 per cent – increased in the second quarter while the manufacturing sector could increase (4 per cent) after the last year's fall. With respect to corporate forms of activity, the shift must be considered to be favourable since the business investments with key role for the recovery of export capacities and economic growth are estimated to have increased in the first six months. It is difficult to assess housing activity in the first six months. While the number of houses delivered was falling, investment statistics produced considerable growth above 8 per cent in the real estate sector.

The improvement of business investments has continued

With the rally of business investments continued and recovery of housing activity, a growth rate of about 5 per cent seems to be feasible for the rest of the year. Therefore, with respect to the performances relatively weak in the first six months, our former investment growth projection (about 4 per cent) should be adjusted downwards somewhat. Accordingly, the investment growth is estimated at 3 to 4 per cent for the whole year.

Annual investment growth is expected at about 3 to 4 per cent

External economic upturn did not improve in the first six months either, having adverse impact on the exports. Trade in goods rose by a rate below 2 per cent in the first six months in which a couple of companies, with significant export performance in the same period of 2002, eliminated their activity partly or wholly. Export of services, especially revenues from tourism largely fell. Thus, the growth of trade in goods and services is estimated not to have exceeded 2 per cent in the first six months.

Exports hardly increased

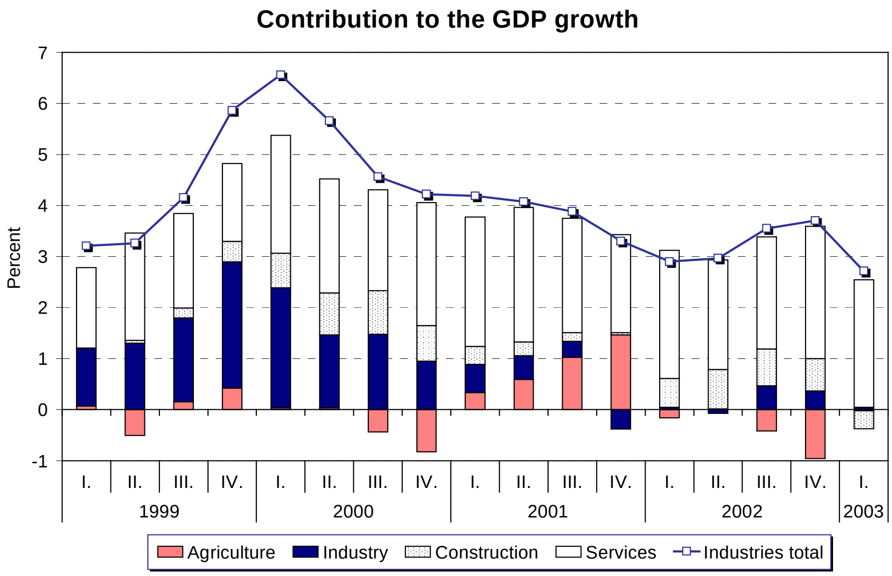
In the second six months, the exports are expected to grow faster due partly to industrial production showing recovery, and partly to growing manufacturing investments and facilitated by the favourable basis effect. In total, even this assumption is not able to justify any adjustment to our export forecast of 3 to 5 per cent as included in the latest Flash Report.

Significant import growth

In the first six months, imports remarkably grew at a pace over 7 per cent. This high growth rate was basically due to the dynamical households consumption and above 10 per cent increase in machines investments. Imports of goods and services are not estimated to decelerate in the second six months either, expecting a growth of 6 to 8 per cent after modifying our import projection upwards slightly.

Higher value added only in the services sector

Trends observed in the output structure of GDP continued in the second quarter as well. Based on preliminary figures, the value added grew only in the services sector. Industrial value added is assumed to have hardly increased while the agricultural value added explicitly decreased due to the hot droughty summer. The value added in the construction that started to grow in the second quarter could only a little offset the large drop in the first quarter. In the rest of the year, the industry including building activity is estimated to improve.



For 2003 as a whole, 3 to 3.5 per cent of growth expected

Due to the growth figures lower than expected in the first six months, our projection for GDP growth of 3.5 per cent for 2003 should be modified downwards. In our estimates, the GDP growth rate may move in the range of 3 to 3.5 per cent in the year. Should economic upturn not be so strong in the rest of the year the growth rate will near to the lower edge despite the fact that because of the remarkable growth of consumption the domestic demand will expand as well.

2.1 Wages and earnings

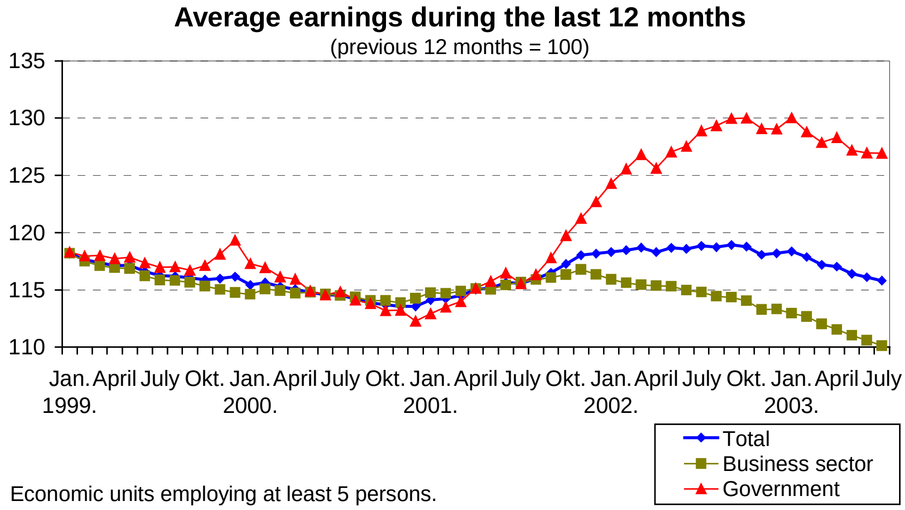
The gap between growth rates of earnings and economic performance narrowed

Monthly nominal gross earnings of full-time employees averaged up by 14.1 per cent in the first six months of 2003 from the same period of the last year, based on CSO figures. In the business sector, pay increases achieved 8.7 per cent while the public sector saw an increase of 24.7 per cent.

Monthly average earnings of full time employees in the first six months
the previous year = 100 (in per cent)

	Total		Business sector		Government	
	2002	2003	2002	2003	2002	2003
Gross earnings	118,3	114,1	114,2	108,7	128,7	124,7
Net earnings	117,9	118,1	114,7	114,6	126,1	125,0
Real earnings	111,3	113,2	108,3	109,9	119,1	119,8

The dynamics of gross earnings of the business sector did not change significantly in the second quarter either, that is, the figures of the first six months are closely the same as those of the first quarter. In relation to the index of gross earnings of 8.7 per cent as seen in the business sector, that of the services sector and manufacturing sector show higher and lower growth, respectively. In this context, the lowest growth is seen for the textile and leather industries (4.2 per cent) and n.e.c. manufacturing earnings (3.7 per cent).



Pace of earnings growth still high in the public sector

Wage developments in the public sector have been determined by the pay increase of public servants in September 2002. As a carryover effect of this pay increase in education, healthcare and social services, earnings were seen to grow at 46 per cent in the first six months of 2003. There are two factors yet to change the annual earnings growth in gross as expected:

- In the second six months, the last phase of civil servants' pay increase underway since 2001 will accelerate the wage growth in the public sector.
- The basis effect of the last year's pay increase by 50 per cent of the public servants will adjust the wage index downwards.

Net earnings increased faster

In the first six months of 2003, the rate of tax credit raised from 1 September 2002 changed the growth rate of gross and net earnings for the benefit of the growth of net earnings. Net average earnings on a national economy basis rose by 18.1 per cent on the average of six months or 4 percentage points faster than those in gross.

Real earnings grow faster than productivity

Earnings in real terms of full-time employees (while the consumer price index increased by 4.3 per cent) rose by 13.2 per cent until June from a year earlier. In the business sector, real earnings rose by 9.9 per cent while public sector saw an increase of 19.8 per cent, both from a year earlier.

Despite the slowing earnings dynamics observed in 2003, growth of earnings and thereby labour cost significantly surpassed productivity gains, threatening economic stability.

Business sector expected to produce gross wage increase of about 8 per cent

Gross earnings in the national economy in total are forecast to increase by 11 to 12 per cent. From the trend of the first six months and the employers' expectations, it is concluded that the gross earnings index on an annual average basis will be 8 per cent or above in the business sector. Annual gross earnings dynamics in the public sector is projected into the range of 20 to 22 per cent or somewhat lower than was in the first six months. The change to the wage bill in gross will still be higher since the number of those employed in the public sector will be raised on the 2003 average.

The annual change to net earnings is expected to near or exceed that of those in gross in every sector. On an economy-wide basis averaged, net earnings will surpass by some 4 percentage points the gross ones. Finally, the real wage will go up by 10 to 12 per cent well above the productivity gains.

2.2 The employed and unemployed

Number of the employed increased in first six months

Based on CSO institution statistics, the number of those employed by enterprises staffed at 5 at the least, as well as those with government and social security agencies in total increased by 1 percentage point. Within this, the number of those employed in the business sector fell slightly (0.2 per cent) while public sector increased staffing by 3.7 per cent.

Based on calculations from CSO unemployment statistics releasing three-month figures, positive signs in employment are seen for the first seven months averaged:

- The number of the unemployed and the unemployment rate dropped;
- The unemployment rate of those between 15 to 24 years of age decreased relative to the surveys early in the year;
- The number of those employed has been higher;
- The number of those economically active also increased.

The number of those economically active rose

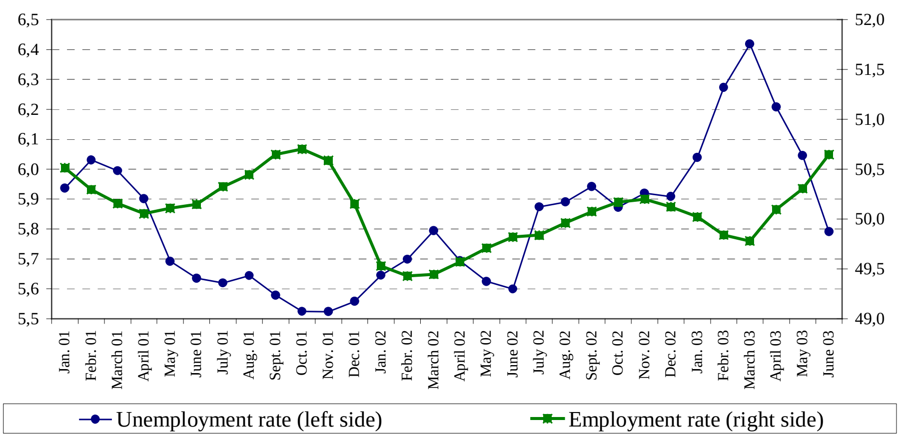
In the age group from 15 to 74, the number of those economically active (total amount of the unemployed and employees) rose approximately by 1.7 per cent in the first seven months compared to the same period of last year.

The number of those employed rose almost 1.5 per cent

In the age group from 15 to 74, the number of those employed rose by 1.4 per cent for the first seven months of 2003 compared to the same period of last year.

The monthly number of the employed projected back to a year before was the lowest in July 2002 when, based on the sampling, the number of those carrying out such an activity with at least an hourly income in the week of the survey was estimated to be close to 3,838,000. In this light, the year 2003 has brought over 3,923,000 in July of the same category.

Employment and unemployment rate
of the population aged 15-74 from January 2001. (%)



6.1 per cent is the seven-month unemployment rate

The unemployment rate estimated to the period of January to July averaged was 6.1 per cent or some 0.3 percentage point above the figure of the same seven months of 2002. Relative to the figure of 6.6 per cent calculated to January, the unemployment rate as calculated from the beginning of the year was more and more moderate from month to month.

The unemployment rate for the youth improved

The unemployment rate of the youth (15 to 24 years of age) for the last three months was seriously lower – 12.9 per cent – than in the first quarter (14.4 per cent). This figure is hardly higher than had been a year earlier. (The rate relating to the same age group of EU countries was 15.2 per cent in March.)

The ILO unemployment rate is expected to be around 6 per cent on an annual average of 2003. The number of those employed will probably modestly rise in the year.

2.3 Consumption and retail trade

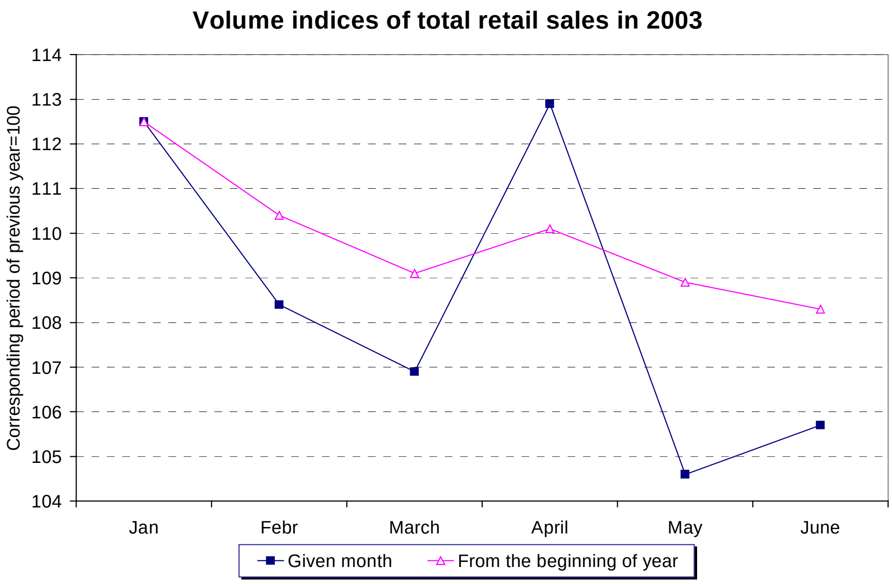
Growth rate of consumption still high

Based on recent CSO figures of national accounts published early in July, the **households' consumption** continued to strongly rise in the first quarter of 2003. Consumption expenditure and social benefits increased by 9.2 per cent and 3.4 per cent, respectively. In total, final consumption by the households exceeded by 8.1 per cent in volume the level of first quarter in 2002.

Growth rate of retail sales mitigated in the second quarter

The volume of **retail sales** continued to strongly rise, though at a mitigated rate. Sales volume excluding vehicle and fuel sales, adjusted for working days and seasonal effects increased by 10.0 per cent, 6.9 per cent and 8.4 per cent, respectively in the first quarter, in the second and in total, compared to the same periods of last year. Within food retailing, the non specialised stores of large surface (hypermarkets, supermarkets) continued to gain ground at the expense of specialised shops.

Total retail sales volume without adjustments exceeded by 8.3 per cent the last year's figure for the first six months. Monthly growth rates were fluctuating, however, at a declining rate:



The volume of catering units falling out of retail trade fell by 4 per cent in the first six months due to the decline in tourism.

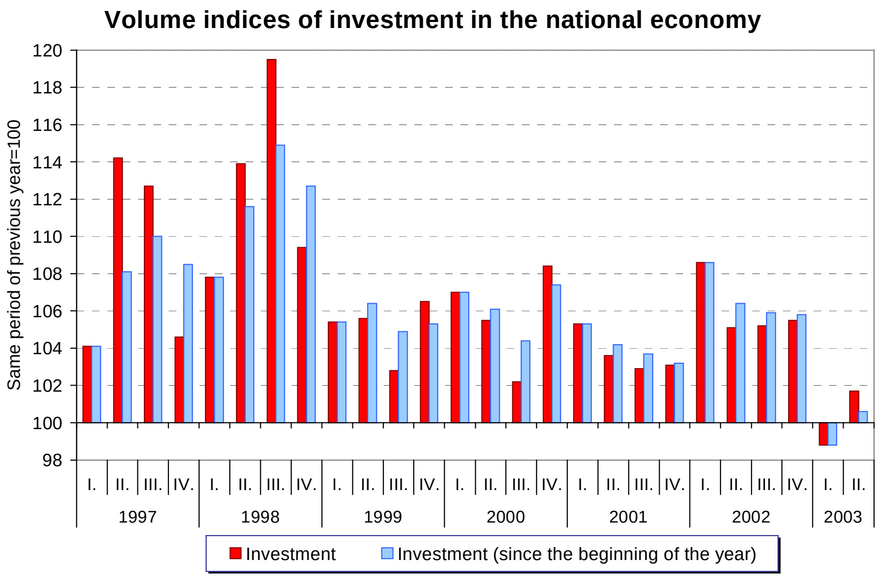
Based on the figures of National Bank of Hungary (NBH), the households' net financial assets (net cash savings) was negative in the first quarter (HUF -7.9 billion). The NBH is to publish the figures relating to the second quarter of 2003 in October.

Based on figures of consumption and savings in the first quarter, and considering the mitigated trend of retail sales, the households' consumption is estimated to grow at 7 to 8 per cent for the year as a whole.

2.4 Investments

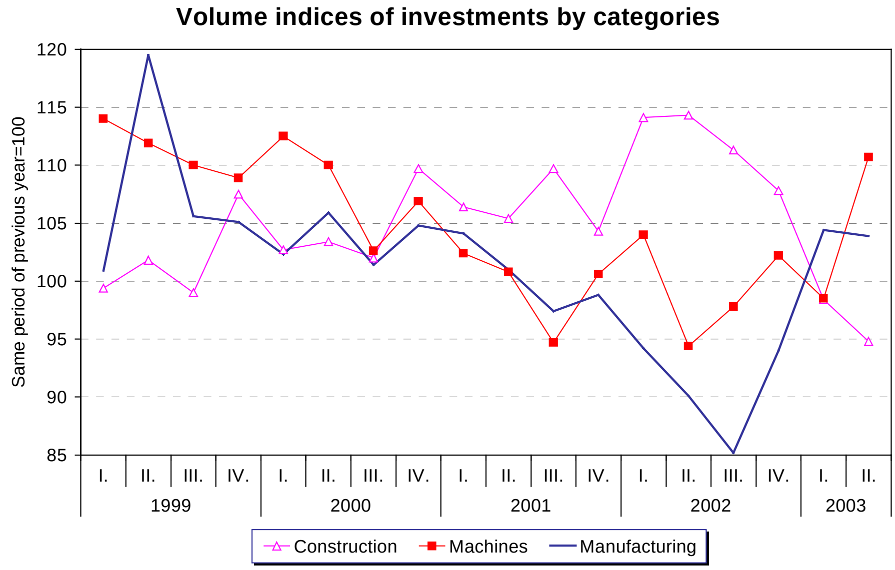
Volume of investments increased by 1.7 per cent in the second of 2003

In the second quarter of 2003, investments of the national economy went up by 1.7 per cent up against the fall of 1.2 per cent in the first quarter (increased by 0.6 per cent in the first two quarters in total).



In addition to the increase of volume of investments, their composition also improved. Business investments expanded while the general government investments dropped

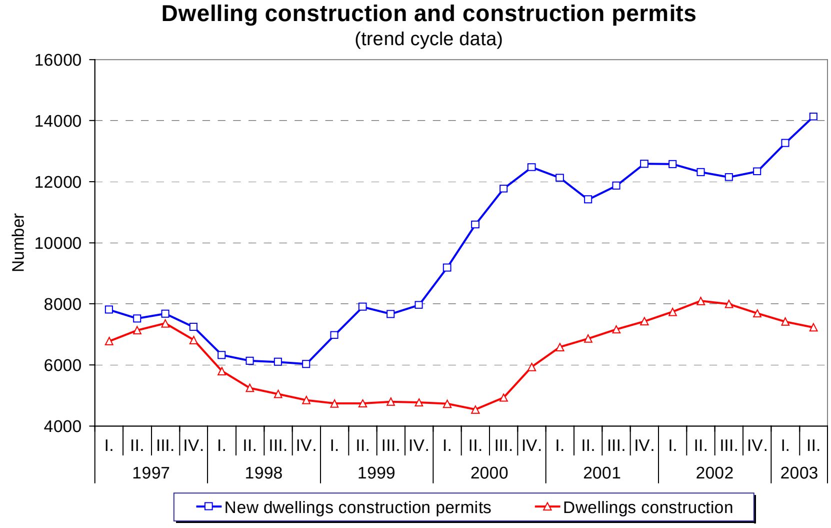
This modest increase in volume of investments (the corresponding figure for the last year was 5.1 per cent) is considered encouraging. It is also evidenced by the fact that the composition of investments further improved as a most significant sign of which business investments resumed to increase after the last year's decrease and stagnation in the first quarter. In the background, there stood the following sectors with investment expansion figures below: manufacturing industry: 3.9 per cent (4.1 per cent for the first six months); agriculture: 28.3 per cent (27.2 per cent in the first six months); wholesale and retail trade: 6.1 per cent (4.9 per cent in the first six months) and financial intermediation: 90.3 per cent (61.3 per cent in the first six months). The volume of investments of corporations with more than 49 employees increased by 4.7 per cent in the second quarter after the fall of 1 per cent in the first. Machines investments increased by 10.7 per cent (5.7 per cent in the first six months) after the fall in the first, clearly suggesting the buoyancy of investments. The moderate growth of building investments – 5.2 per cent (3.9 per cent in the first six months) – is heading for a more balanced direction in anticipation of a weakening dominance of infrastructure investments financed by the general government.



As another component of structural shifts mentioned above, government-financed investments also went through marked changes. Following the last year's high growth, similar volume shrinking is likely for the first six months (the volume of public administration investments increased by 32.2 per cent in 2002 while fell by 37.4 per cent in the first half of this year and 19 per cent in the second quarter, respectively; investments by general government fell by 13.6 per cent and 16.2 per cent in the first quarter and in the second, respectively). Households investments were mainly housing activity where the number of dwellings put to use delivered in the first six months (9181) was lower than in the reference period. However, investments in the real estate section including housing activity went up by 8.1 per cent. With this in mind, we assume that the volume of households investments increased despite the drop in home delivery in the first six months.

Home-building activity went down in the first six months0 but in the year as a whole, home delivery is expected to surpass the corresponding last year's figure

The number of homes (9,181) put to use until 30 June 2003 was 8 per cent lower while the number of home-building licences issued (25,902) 15 per cent higher than in the same period of last year. Accordingly, the number of homes finished further declined in the second quarter as observed in the first while the number of licences issued dynamically and continuously increased. For the decline in the first six months, the delivery drop of homes for selling purposes by entrepreneurs was crucial. The increasing number of home-building licences issued is, however, a sign of future growth in this activity.



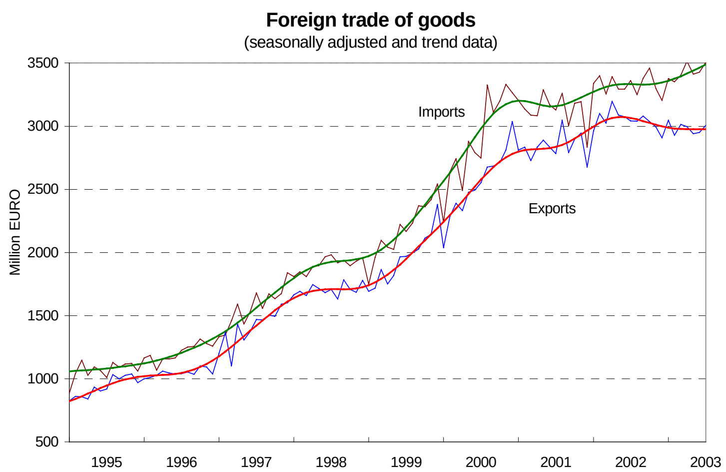
In 2003, the volume of investments will increase by 3 to 4 per cent; structure improving

In our assumption, the volume of investments will increase by 3 to 4 per cent and the structure thereof also continue to improve. In addition to increasing volume of business investments, the development of housing (higher number of dwellings delivered) activity is also assumed. Accordingly, dwellings delivered in the second six months should overcompensate the performance in the first. Shrinking of general government investments is assumed to be mitigated throughout the year. Investment ratio is expected at about 22 per cent for the whole year.

2.5 Foreign trade

In July, the value of exports grew while the gap in pace between exports and imports narrowed

In July, it was the first time for a longer period that the gap in pace between exports and imports (still for the latter's benefit), narrowed. While excluding January, the negative balance deteriorated from month to month by EUR 200 to 300 million in the first six months of the year measured against the previous year, the deterioration was only EUR 120 million in July. After the fall of exports in the previous months (at an accelerating pace from March), the increasing value of export rose 3.4 per cent (in EUR terms), coupled with the growth of imports by 6.7 per cent (including adjustments to be expected).



In the first seven months of 2003, the **exports** made up EUR 20.8 billion or 2.6 per cent lower than had in the previous year excluding the adjustments expected and based on preliminary data. (In USD terms, exports went up 19 per cent in HUF terms down nearly 1 per cent from a year earlier). In voluminous terms, exports will surpass by 3 per cent the last year's figure. (In July, the growth was much higher.) In EUR terms, it was only the main commodity group of machinery (with the exception of raw material export of insignificance weight the growth of which was 13 per cent) to achieve growth in value at 1.1 per cent. In the other main commodity groups, the exported value did not achieve the last year's level. Exports of manufactured products with significant weight fell in value by more than 10 per cent. Food exports fell in value by 2 per cent while in volume remained roughly the same as had been last year. At the same time, export of cereals fell significantly.

Engineering exports had a major role in the modest export growth

The value of **imports** in EUR terms increased by 2.9 per cent to make up EUR 23.8 billion (increasing by 25 per cent and almost 5 per cent in USD and HUF terms, respectively) while in volume the growth was about 8 per cent. The imports for consumption and investment purposes also increased while the fastest growth was seen for the energy sources. Machinery imports rose less than 1 per cent in EUR terms while in volume, the growth was more robust. Excluding the energy sources (making about 8 per cent of imports in total), the value of imported foods (with a weight of some 3 per cent) and manufactured goods (more than 50 per cent of the imports in total) rose fastest (both of them 5 per cent). In the context of machinery imports, the imports of machinery of general purposes and means of transport increased much faster than the average including particularly the imports of cars. Also, fast growth was seen for telecom imports, notably for the mobile phones. At the same time, imports of electric machinery and devices fell while the imports of integrated circuits significantly dropped. In the main commodity group of manufactured goods, medicine imports grew two times more dynamically than the average.

Imports increased in every field; the increment made crucially by manufactured goods and machinery

The **relational** structure showed the following features. The balance deteriorated against all the three main groups of countries, particularly against the advanced countries. Trade with Eastern European countries rose well above the average. Some deterioration in balance emerged despite the fact that the pace of exports somewhat exceeded that of the imports in these relations. Against developing countries, the balance deteriorated a little. In this context, the biggest deficit arose in the Chinese relation.

Trade balance deteriorated in all the three major relations. The fastest decline seen with the advanced region

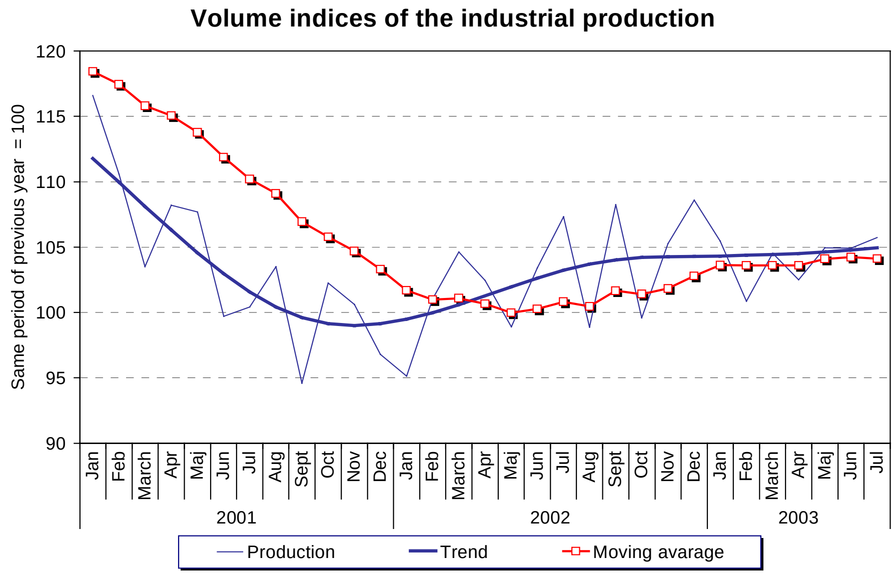
Trade deficit deteriorated by EUR 1.2 billion in total (or USD 1.7 billion and HUF 315 billion) making close to EUR 3 billion (2982 million). This deterioration has a major role in the poor current account positions as well.

Trade balance deteriorated by EUR 1.2 billion

2.6 Production

Industrial production recovered in July

Based on preliminary CSO figures, in July the **industrial production** overrode its last year's growth of almost 10 per cent by further 5.2 per cent. Thus, it grew by 4.1 per cent in the first seven months of the year.



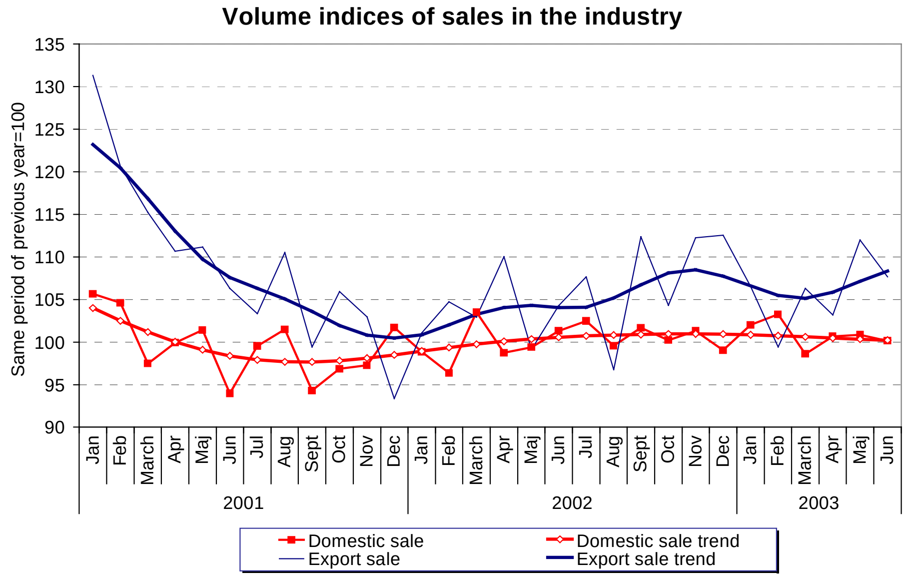
Details are available until June. In particular, the industrial production increased at a much higher pace (3.9 per cent) than in the first six months of 2002 (0.7 per cent).

Industrial productivity rose almost 7 per cent

Per capita industrial output rose by 6.6 per cent in the first six months (under staffing cuts at a declining pace, 2.4 per cent). Productivity gains in the manufacturing sector were left 0.6 percentage point behind.

New industrial export orders promising

Growth rate of **industrial export sales** doubled the previous six-month's figure. The volume index of new export orders of manufacturing branches with priority showed an outstanding rise of 56 per cent in June. Orders more than doubled in the electric engineering including electronics and increased by 20 per cent in vehicle manufacturing industry. At the same time, export sales prices were 2.4 per cent lower in the electric engineering in June while in the vehicle manufacturing those were 2.2 per cent higher than had been a year earlier. The food industry with a weight of 5 per cent in the total exports could also set off well the slump in domestic sakes with export sales increased by almost 7 per cent.



Manufacturing production increased by 3.5 per cent in the first six months. In the context, the fastest growth (13.2 per cent) was seen for vehicle manufacturing, and then the branch of electric engineering and devices (9 per cent). Food industry production fell by 2 per cent in the first six months. In context of traditional light industry, branches of leather and textile production showed the signs of a heavy crisis. Their output fell again after the last year's fall to be lower 23 or 11 per cent, respectively, than had been in the first six months of 2002.

Growth of manufacturing production left behind that of the industry

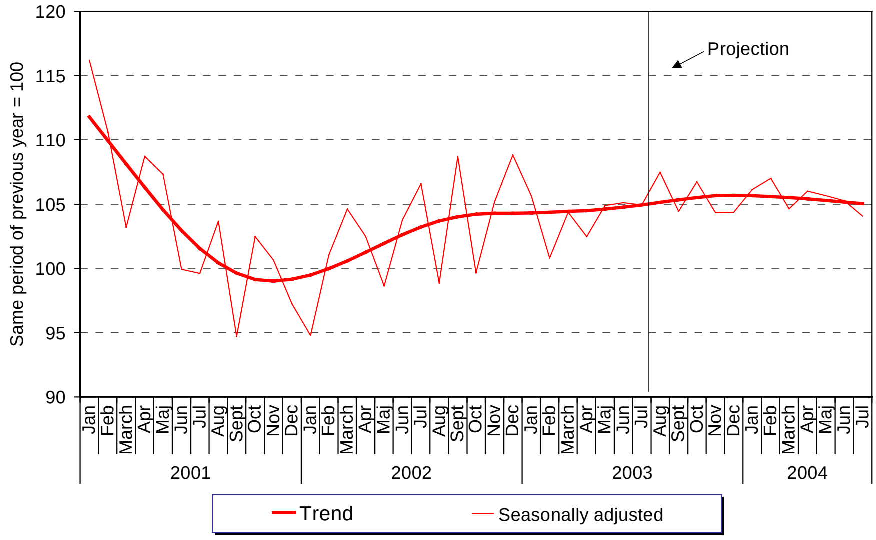
Manufacturing enterprises had to struggle several adverse developments in the recent years. While global economic downturn had a key role certain domestic, otherwise necessary, measures also deteriorated the domestic business environment. For example, the increases of minimum wage made work in commission more expensive as a result of which jobs and factory units were eliminated. Given that work in commission was vital for some branches of light industry their impact particularly arose in this relevant field. The negative consequences of the strengthening exchange rate of Hungarian Forint affected a wider group. In particular, all the exporting firms were involved that could not offset the adverse processes by the benefits realised on imports. As a result, exporting firms using domestic raw materials were at a sensible loss. To the contrary with our expectations the increasing domestic demand did not involve increased demand for domestic industrial products let alone the vehicle industry.

Adverse circumstances influencing industrial production in the near past

The APEH's summary of tax returns on corporate income for 2002, recently worked out, should confirm the conclusions of the analysis above. In particular, cost efficiency came at the forefront in the management of undertakings. It would be positive if coupled with a robust productivity growth. However, profit before tax of manufacturing enterprises with double-entry book-keeping rose in 2002 only 8 per cent at current prices being left behind the nominal GDP growth of the national economy (14 per cent). This is a clear indication of a narrowed market. At the same time, their forced efforts proved to

Conclusions from 2002 figures of corporate tax returns be successful since their loss before tax fell by more than 30 per cent from a year earlier while the figures show an extreme dispersion between branches. Personal outgoings rose 8 per cent while material ones fell almost 1 per cent. Accordingly, the ratio of personal outgoings increased (by 6 per cent) in relation to net sales revenue while the ratio of material outgoings fell (by almost 3 per cent) in relation to net sales revenue due partly and probably to the cheaper material imports as a consequence of HUF appreciation, also implying that undertakings could not set off their increased wage bill by increased efficiency of material outgoings. It was food industry to increase profit to the highest extent (17 per cent) while the profit of electric engineering rose only 0.6 per cent. The output value per undertaking fell by 4 per cent from a year earlier while the productivity grew, thus, the output value per worker rose 6 per cent. In the cluster of enterprises under review, staffing on the average fell 4.1 per cent or 31,000 during one year. Among the branches of manufacturing sector, it is only food industry to have increased – by 2 per cent – its staff number.

Volume indices of the industrial production



In preparing forecast for 2003 industrial production, several aspects should be considered. Provided that the increase of new export orders will continue at a similar pace, the volume index of industrial production is likely to be about 4 to 5 per cent for the year as a whole.

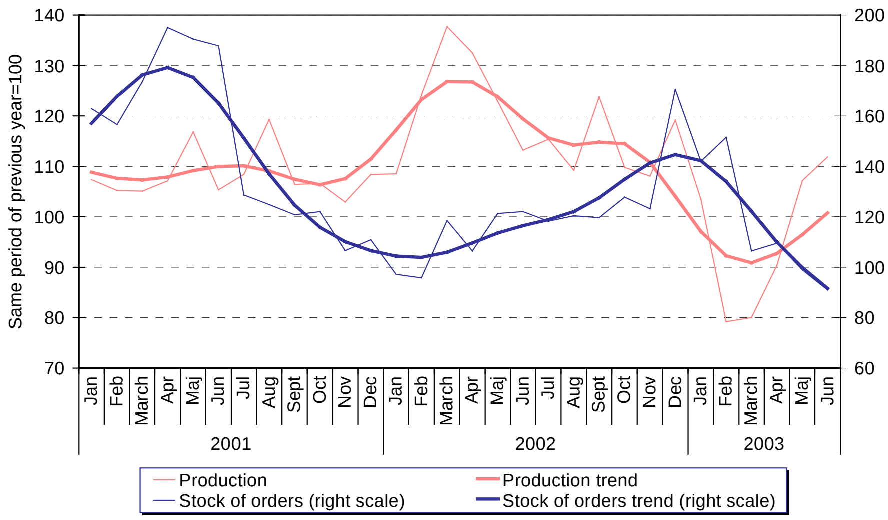
Best-case scenario suggests industrial production to increase by 4 to 5 per cent

The **construction performance** for 2002 was outstanding at 18 per cent of growth followed by a decline due to various factors. In addition to the high basis, an extraordinarily tough and long-time period of cold weather as well as, last but not least, the decline of orders from the central government and local governments. As a result of the processes above, the construction performance fell by 3.8 per cent in the first six months, down against the last year’s corresponding figure of 23 per cent of growth. The growth rate of building of complete constructions representing almost 60 per cent of construction output fell from month to month in the first quarter while increased from month to month in the second to exceed by 15 per cent in June the growth at 14 per cent a year earlier. However, even through this dynamics, the building performance

Construction output declined

in the first six months was 11 per cent lower than had been a year earlier. The growth rate of building installation making 25 per cent of this sector however showed strong dynamics except for two months to surpass the basis (27 per cent) of last year's first six months by 12 per cent.

Volume indices of production and the stock of orders in construction



As seen in the Graph above, the stock of orders seems very adverse. The volume of contracts in June was 9 per cent lower than had been last year. The stock of new orders seems still worse. New contracts signed in the relevant month and new stocks of orders accumulated from the beginning of the year were almost 30 per cent and 44 per cent, respectively, left behind the last year's corresponding figures.

Stock of contracts not encouraging either

Construction performance in the year is dependent on the stocks of contracts in the following months. Assuming a monthly 10 per cent of growth in the stocks of new orders for further months, the construction performance for 2003 may exceed the last year's result by only 4 to 5 per cent.

There is much uncertainty about construction performance for the year

Arable land was further shrinking but insignificantly while its composition by branch of cultivation remained roughly the same. Sowing area of cereals and potatoes fell while that of sunflower, fruits and wine-grape increased. In an August survey, number of cows and shepherds dropped while that of pigs and poultry increased. This year, weather conditions were very adverse for the sector. After a long-lasting, harsh winter, the fruit-gardens suffered significant losses of frost, then followed by an extraordinary period of drought and heat from May resulting in an output drop almost across the whole spectrum of non-irrigated lines. However, the biggest loss was seen for crop farming. Based on AKII (Agricultural Research Institute) wheat and corn yielded 1 million tonnes or 20 per cent less from the not-so-good year of 2002.

Composition of agricultural areas unchanged while weather conditions turned for the worse

Procurement of agricultural products fell by 0.8 per cent in January to June. Livestock and animal products sales increased by 6 per cent while their producer prices were lower from the last year's same period to the same extent. Procurement of plants and vegetables significantly fell by 18 per cent except for wine while producer prices increased in the year. Although the producer price index of agricultural products in the first six months showed a fall by 0.4 per cent, analysts say that producer price index is expected to increase in the second.

Agricultural procurement fell

Due particularly to the damage caused by adverse weather conditions, the agriculture's 2003 performance is likely to maintain but not exceed the level achieved in the poor year of 2002.

Agricultural production not expected to grow

Enterprises in the **transport sector** produced an amount of goods transported in the first six months 6 per cent lower than had a year earlier. The performance measured in tons of goods a kilometres increased by 1.6 per cent in the context of which the railways, water and pipeline transport registered 2.3 per cent, 1.7 per cent and 10.0 per cent of growth, respectively while road transport dropped 3 per cent. The number of passengers delivered in distance transport services fell by 3 per cent while local public transport was stagnant.

The performance of transport sector dropped

3. Monetary flows

3.1 Central bank measures

To brake off weakening exchange rate following the change to the fluctuation band, the NBH raised its governing rate paid on two-week deposits from 6.50 to 7.50 per cent on June 10. The HUF exchange rate continued to weaken even so. In the Monetary Council's opinion, the process of weakening achieved a level lower than justified by economic fundamentals. Therefore, another increase of interest rate was carried out on 19 June by 2 per cent to control the adverse effect from the exchange rate on the inflation.

Interest rate increases to stabilize exchange rate

The President of the National Bank of Hungary participated in the government session of 16 July to express his support for the Government's intention of joining the euro zone in 2008 and his agreement to a tight economic policy stance to restore the balance.

Central bank for accession to euro zone in 2008

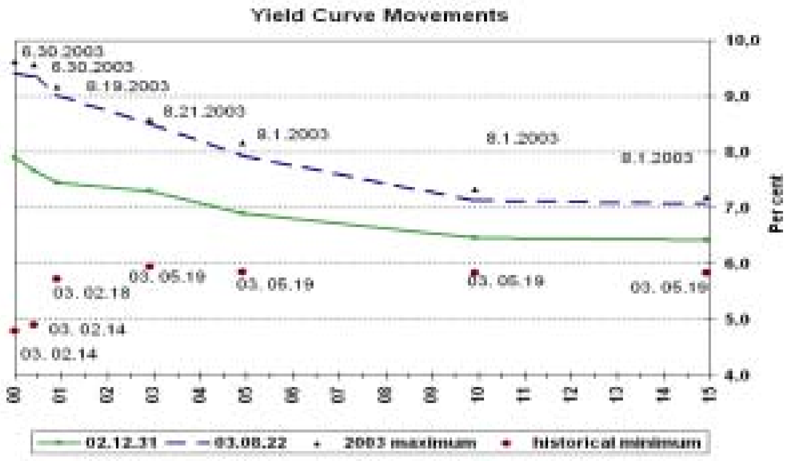
The increase of yield as a result of second interest rate increase (by 2 per cent) led to the stabilization of HUF exchange rate in the range of 250 to 260 HUF/euro as held necessary by the NBH for Maastricht criteria to be met. In its communication published at the time of its inflation report, the Monetary Council announced that interest rate cut would be possible only if the HUF exchange rate remained permanently and stably in the stronger side of the band of 250-260 HUF/Euro.

Interest rate cut unexpected but in case of a further strengthened Hungarian Forint

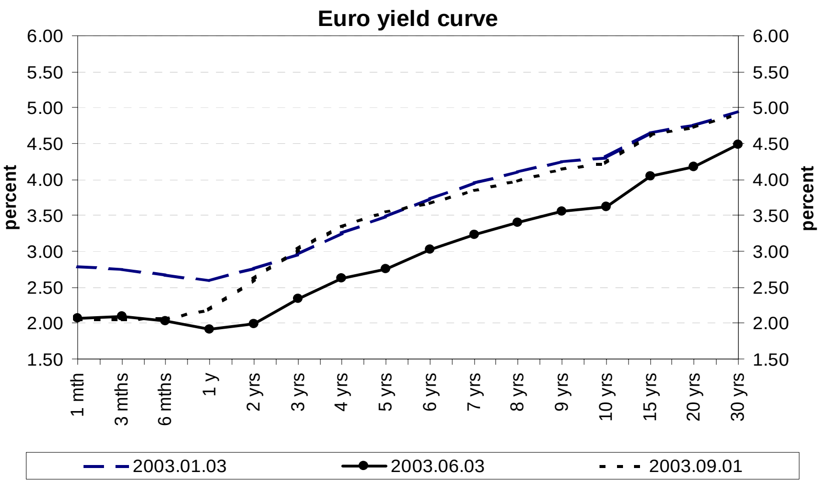
3.2 Yield and interest rate

Yield curve inverse again and made a stride upwards

The two interest rate hikes substantially changed the flat shape of the yield curve as emerged from February to May. While at May-end, every yield was roughly 6 per cent, by early September, every part of the yield curve significantly increased and became inverse again. Expectations of interest rate cuts of 25 to 50 basis points were priced in/out in the short-term yields in parallel to HUF strengthening/weakening. By the end of August and early September, the market had not however counted on interest rate cut even on HUF strengthening, showing a better credibility of exchange rate target. Long-term yields went up more than 100 basis points following the increased uncertainty about the investment in HUF securities both in relation to yields and the exchange rate. In addition, euro yields terms increased. The yield level through September was corresponding to that a year earlier.

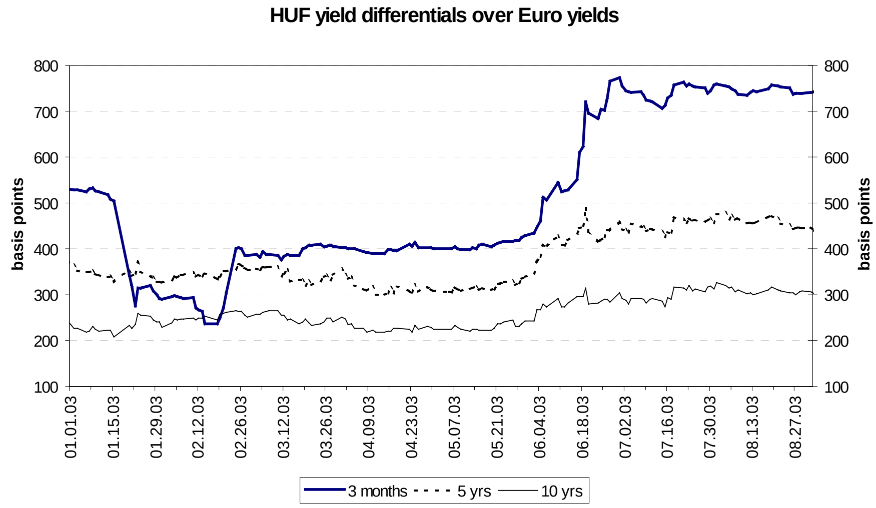


HUF yields are closely related to euro yields in which fundamental change was made in the recent months. On June 5, the Governing Council of ECB reduced its key interest rate by 25 basis points to 2 per cent due to unfavourable economic outlook and favourable inflation. In the middle of June, a trend of more than one year was broken, and euro yields started to grow. As a result of the historically low base rate, the short-term yields did not increase.

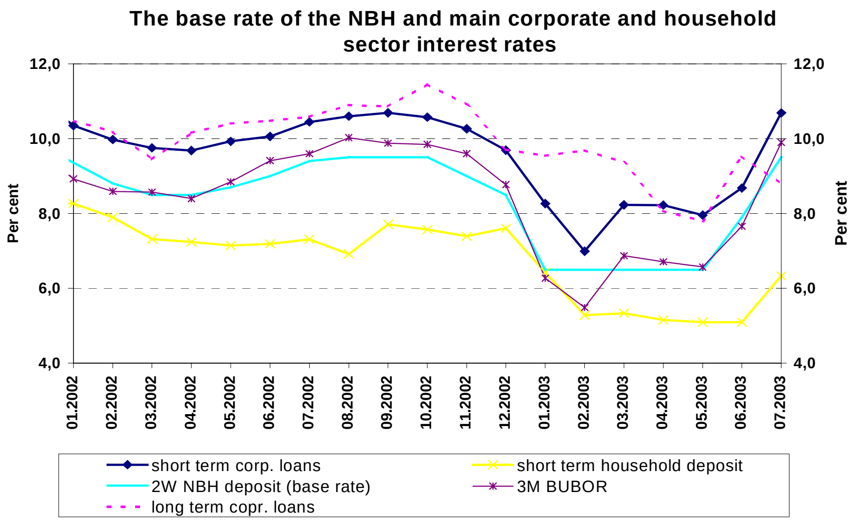


Hungarian interest rate premium over the euro grew significantly

Since the Hungarian interest rate premium over the euro had been stable for 4 months, the spread significantly enlarged due to the interest rate hikes in June. In line with three-month yields' higher volatility, the three-month spread changed to a bigger extent, thus the spread raised from 400 basis points to about 750 basis points. Meanwhile, the Czech and Polish premia remained stable, therefore, the Hungarian spread was far the highest in the region, otherwise similarly to the former status.

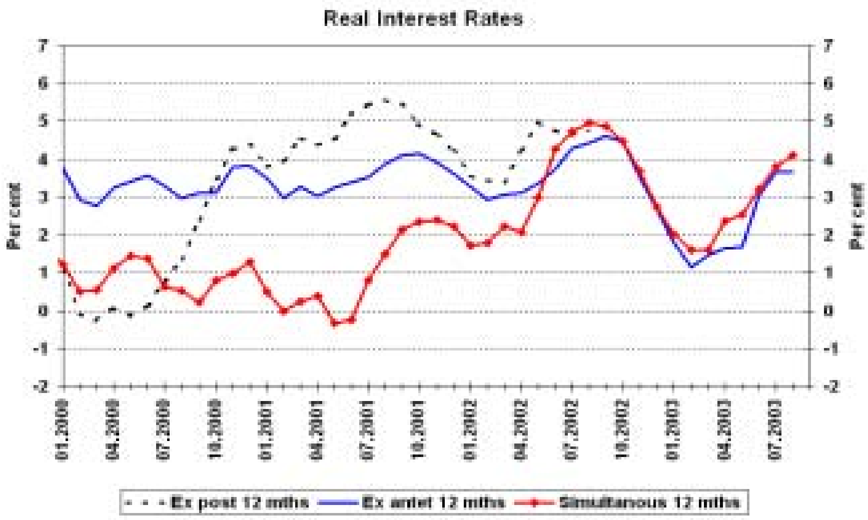


The three-month money market interest rate increased by 300 basis points since June in line with the key rate of the central bank, fluctuating about 9 to 9.5 per cent for three months. The short-term interest rate to non-financial enterprises also followed quickly the change of three-month rate and thereby that of the policy rate. However, average long-term interest rate fell due to a one-off effect. The households' interest rate also increased but with a greater delay than in the other segments.



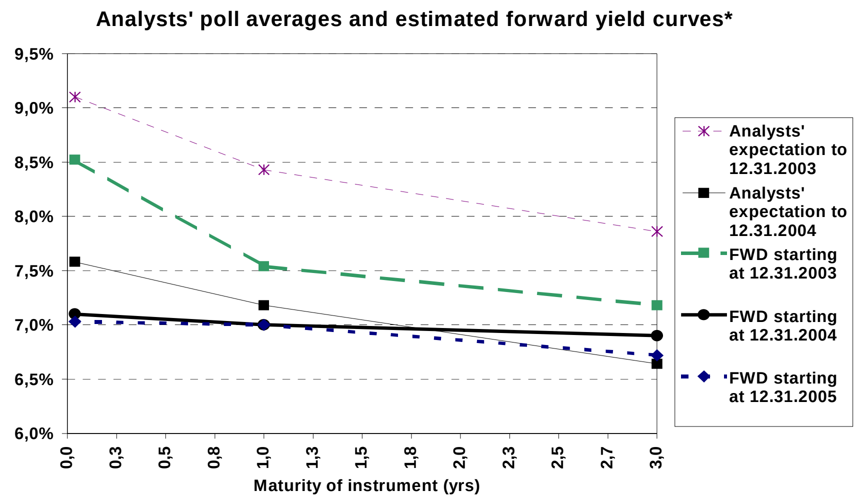
In the recent months, the real interest rates started substantially increase, especially the development of the ex ante rate should be remarkable. While it was below 2 per cent in May, raised to two times as high by August. The reason of raising is the increasing interest rate level. However, as a result of higher inflation figures, the ex post rate resumed to modestly fall.

Ex ante real interest rate doubled



The ex-post real interest rate ratio: yield of one year discount treasury bill issued 12 months ago, deflated by the current inflation. Ex ante: current one year discount treasury bill yield deflated by the inflation rate expected by analysts to develop in a year’s horizon. Simultaneous: current yield to current inflation rate.

In parallel to effective development of yields, expectations also changed significantly in recent months according to analysts. The central bank's key rate will not change any longer this year, and it will fall by 200 basis points next year in total. Both analysts and the market expect general yield fall in the years ahead.

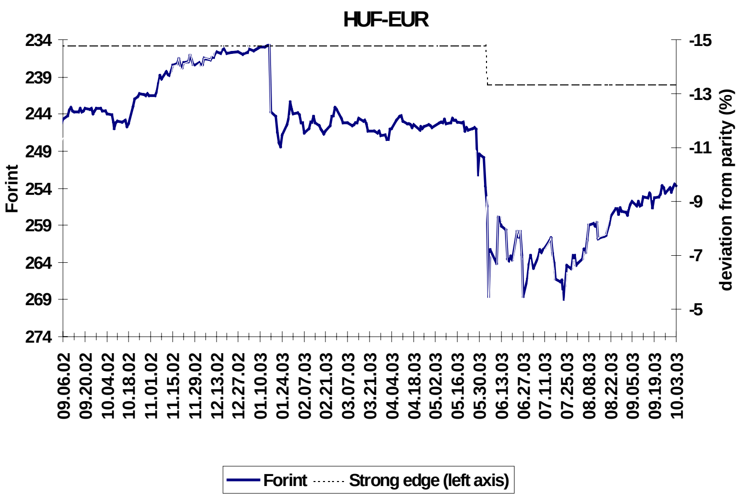


* For market expectations to be measured, we use two forecast methods. The Reuters prepares monthly surveys for the interest rate level expected by the analysts of the two-week deposits and government securities of 1 and 3 years. In addition, from the basic figures of subscription in the government securities market forward yields are estimated (Svensson) with starting dates and terms equal to the projection of analysts.

3.3 Exchange rate

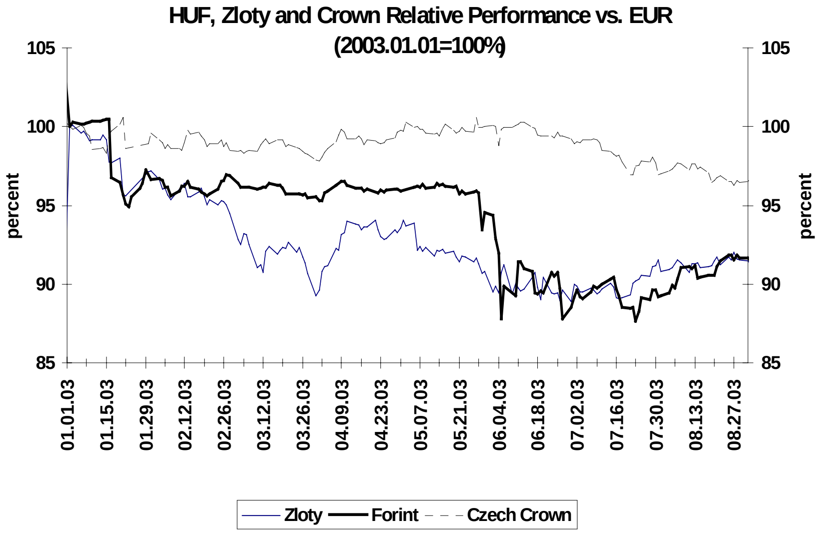
On June 4 the Government, in agreement with the National Bank of Hungary, changed the central parity of HUF. The intention of this decision was to give appropriate orientation to financial markets and the business sector about the relationship between the exchange rate and economic fundamentals. The objective of this move was not to make influence on the current exchange rate in the market but explicitly intended to set a limit at 240 forint/euro in case a possible HUF appreciation due to speculative attacks. As a result of the communication with insufficient initial efficiency and exaggerated responses by the market, the HUF exchange rate significantly weakened (to 260 to 270 forint/euro). Due to the interest rate increases carried out, improved communication and economic policy programme announced, the market slowly regained its balance, exchange rate volatility fell and the exchange rate has become stronger than 260 forint/euro from the last third of August. The exchange rate in the range of 250 to 260 forint/euro is to give chance both to the continued disinflation process and maintaining or improving competitiveness. The credible and consistent economic policy as well as the coordinated and efficient communication of Government and NBH are all to facilitate that the exchange rate should permanently move at this desirable level. The most recent Reuters poll in August disclosed the analysts' expectations found similar to the abovementioned. According to this, the exchange rate of 257 forint/euro and 252 forint/euro are likely for December of 2003 and 2004, respectively.

Following the change is the central parity of HUF, the exchange rate temporarily significantly weakened, then the markets slowly regained their balance, the exchange rate has become stronger than 260 forint/euro from the last third of August; its volatility fell



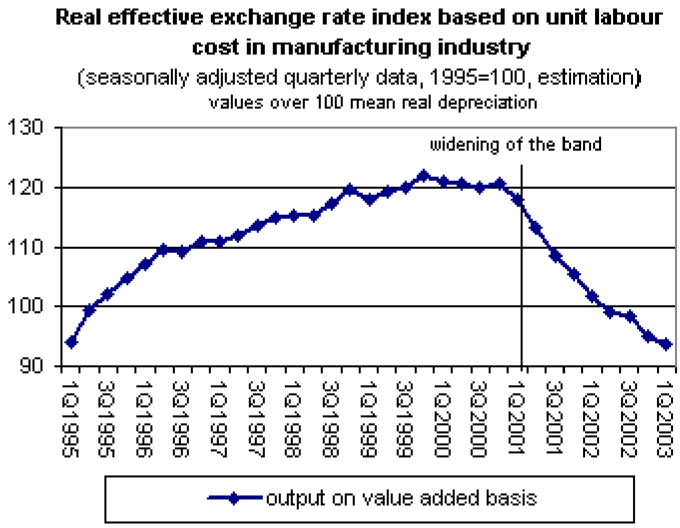
The exchange rates of Hungarian Forint and Polish Zloty significantly fluctuated in this year. Since early June their performance have improved and their developments have been significantly similar. The Czech Crown remained substantially stable throughout the year.

HUF exchange rate similar to that of Zloty since early June



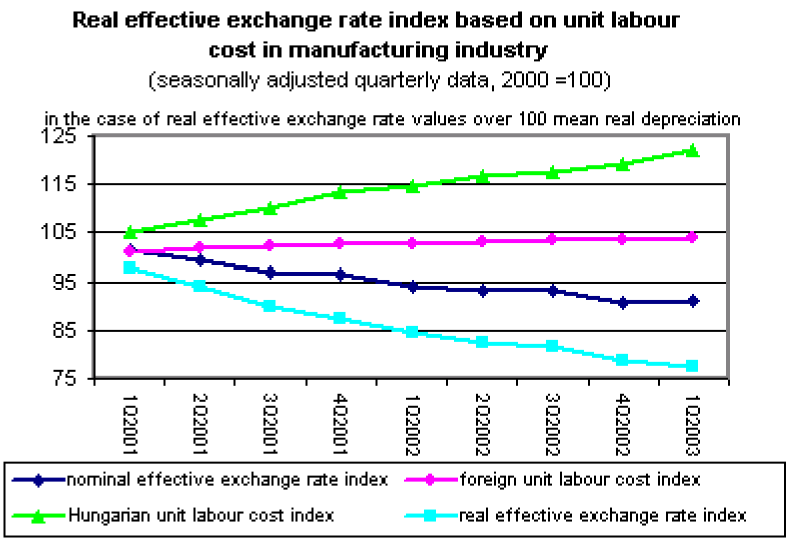
The competitiveness of the Hungarian economy which was good in international comparison a few years ago has deteriorated in 2001-2002 and our position has shifted in an adverse direction compared to our main competitors. The inconsistencies of economic policy and economic developments lead to the appreciation of the Forint while the adjustment of wages to the declining inflation rate was delayed and slow amidst the tight labour market conditions. During the past two years, the real appreciation was 16 per cent and 18.4 per cent based on consumer price index and unit labour cost in manufacturing industry, respectively. According to the latter index, competitiveness in first quarter of 2003 fell back to the level of first quarter of 1995.

The real effective exchange rate index showed a significant deterioration of competitiveness in the past two years



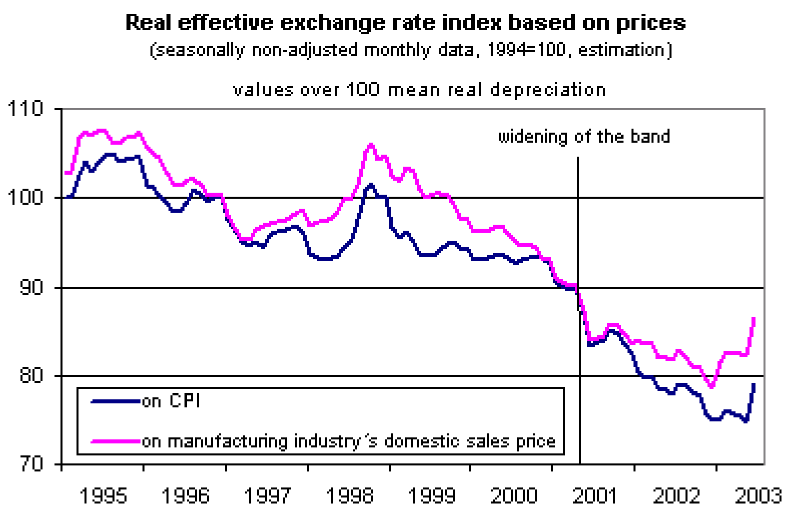
For the real effective exchange rate index based on unit labour cost, the wage increase - well over the level reasonable in relation to the moderate productivity gains - was a key driver in the past two years and the first quarter of 2003 (until then there are official figures available), in addition to the appreciated exchange rate.

Fast wage increase contributed to deterioration of competitiveness



According to the real effective exchange rate index based on consumer price index, in comparison of the average of the first half of 2003 with the same period of 2002, it is established that real appreciation further increased, although at a pace with significant deceleration. In relation to the previous year-end, however, no deterioration was experienced for the first five months of the year. In June, the trend shift was significant due to the weakening nominal exchange rate, and competitiveness began to improve. (The trend all the more applies to the real effective exchange rate index measured on domestic sales price index of manufacturing industry where even the average of first six months does not indicate any deterioration.) The growth rate of unit labour cost may be lower in the future due to the improving consistency between productivity gains and wage increase, and if coupled with the weaker HUF exchange rate of 250 to 260 forint/euro still supporting disinflation it may bring favourable changes in cost competitiveness as well. The exploitation of growth potentials of the economy allows for no more than 1-2 per cent per annum real appreciation as the average of a longer period. In 2003, this requirement can be fulfilled in respect of the real effective exchange rate index based both unit labour cost and on prices and it developments are favourable competitiveness may improve.

Deterioration of competitiveness slowed down in the first half of the year; should the level of nominal exchange rate move within the range allowing for disinflation to be continued, and should the better consistency between performances and wage outflow be developed, competitiveness may improve



3.4 Financial markets

3.4.1 Banks, insurance companies and funds

Stable financial sector, increasing balance sheet total

In the banking sector, the share of foreign ownership further increased in the first quarter, nearing 80 per cent. The liquidity surplus generated by the January speculative attack had a significant impact on the balance-sheet structure. The balance-sheet total rose 4.5 per cent during a quarter after significant growth and fall.

As a result of the funds flown in the country, the share of liquid assets largely increased, and the normal conditions relevant to 2002 had been restored only by March. The share of credits to total assets changed accordingly and hectically while in absolute terms, this share increased from time to time. Similarly to the former period, households raised their loan portfolio faster than the business sector. Remarkable that foreign exchange loans to households strongly increased although their weight remained marginal. Client deposits fell consequently the ratio of deposits to loans sank below 100 per cent.

The quality of portfolio of banking system did not change significantly in the first quarter, thus preserving its high quality even at international level. The sector's result and profitability significantly improved in comparison with the same period of previous year. Capital adequacy was still stable. In the quarter concerned solvency ratio increased again.

The insurance companies' balance-sheet total as well as premium revenue realised rose further. The sector's insurance-technical reserves and its security capital significantly grew compared to the first quarter of 2002.

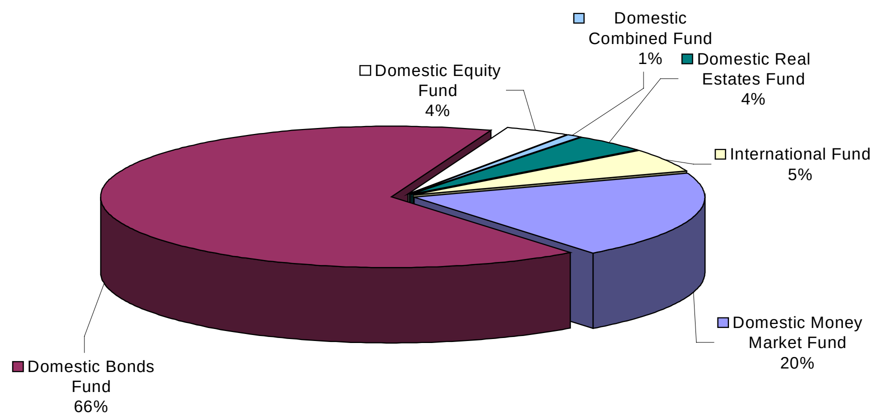
Private pension funds and voluntary pension funds were still dominant in the funds' sector. The number of membership did not change in the former, remaining lower than had been in the same period of 2002. However, the fee revenues strongly increased, since the fee rose by 1 percentage point. The assets managed by the funds grew by 8 per cent and 35 per cent in the quarter and over one year, respectively. The portfolio structure did not change significantly, government securities kept their dominance.

3.4.2 Investment funds

Dynamic expansion of investment funds stopped in the second quarter

In the second quarter of 2003, the trend of investment funds' assets changed. Net assets after a longer-time increase made a shift to fall due partly to the price drop caused by higher yields, and partly to the weakened propensity to buy. The portfolio managed in money market and bond funds fell in view of the whole second quarter while net assets value of real estate funds further increased dynamically (by more than 50 per cent in the quarter).

Investment funds*



* Source: Bamosz, 30. June, 2003

3.4.3 Equity market

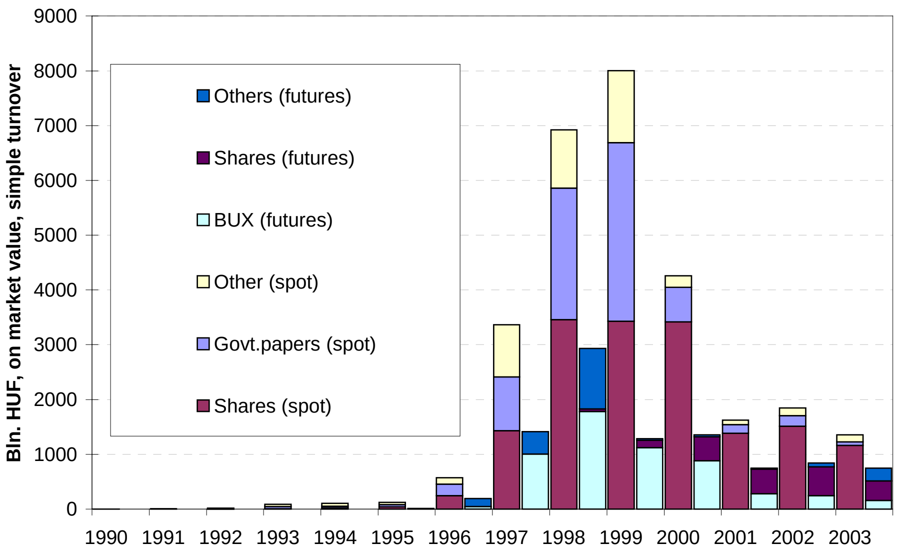
Improving international conditions

In the period since the Flash Report published in June, international economic conditions improved, investors' and consumers' expectations were more optimistic, and all this was reflected in the world's equity markets as well.

BUX increase was moderate

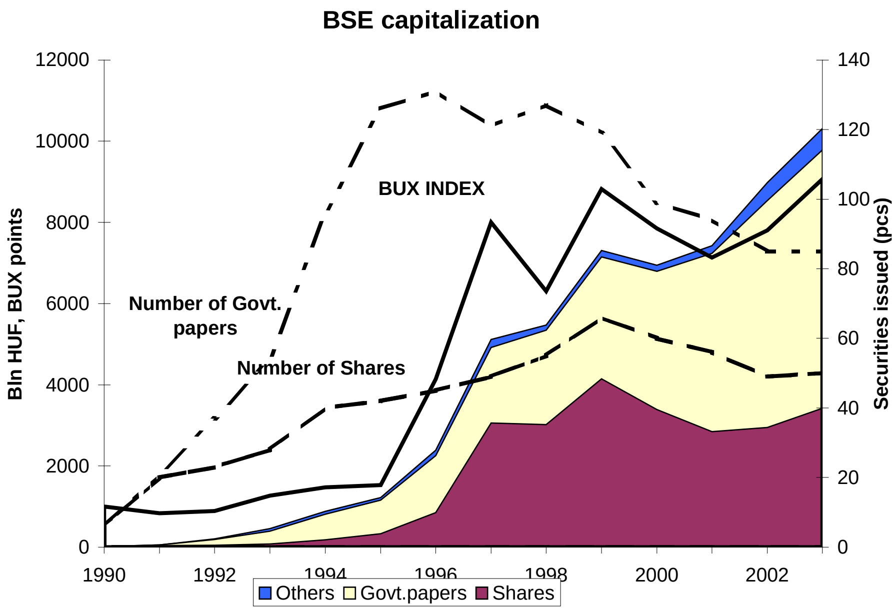
The Budapest Stock Exchange Index (BUX) fell following the shift in fluctuation band unlike international market trends, and then increased but at a moderate pace compared to the surrounding countries.

BSE prompt and futures turover



In the first eight months of 2003, spot and forward transactions both increased compared to the same period of 2002 (by 16 and almost 70 per cent) respectively. In the spot market, the shares are to make the major part of sales while the greatest growth was seen in the market of mortgage securities, which commit or absorb considerable amount of retail funds, mostly from the market of government securities. It was share transactions to make a half of forward sales.

Share section continued to dominate

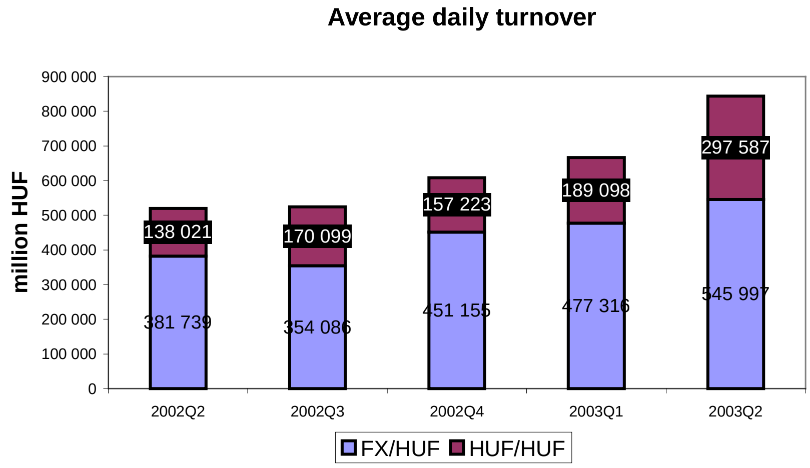


Full capitalisation of Budapest Stock Exchange (BSE) was more than 23 per cent higher than had been in the first eight months of 2002 explained by particularly capitalisation raised of government bonds and corporate bonds.

3.4.4 Foreign exchange market

Sales increase in the foreign exchange market since the widening of the HUF fluctuation band and foreign exchange liberalisation continued in the second quarter of 2003. Daily sales on the average exceeded HUF 840 billion. First of all, the foreign exchange / foreign exchange segment's sales growth by almost 60 per cent (HUF 110 billion) caused the daily average sales growth in the second quarter while the increment of HUF 70 billion in Forint/foreign exchange relation as well. Sales growth could be explained by macroeconomic factors, growing deficit of the current account and high volatility of exchange rates and yields relevant in the period.

Sales in spot transactions fell while contracts of derivatives significantly grew



Fall of spot volume and growth of swaps volume continued

Continuous fall of spot volume since 2001 year-end, and in parallel, the growth of forward volume, (particularly from swaps) markedly continued in the recent quarter after the trends of opposite direction as evidenced in the first quarter of 2003. While spot sales somewhat dropped, the swap segment increased by almost HUF 200 billion.

The banks implement the related transactions in the market mostly (80 to 85 per cent) with foreign investors. It also implies that hedging the exchange risk increased in the extended fluctuation band was still not a general practice for resident firms.

4. Inflation

Raising price index followed a fast seasonal disinflation

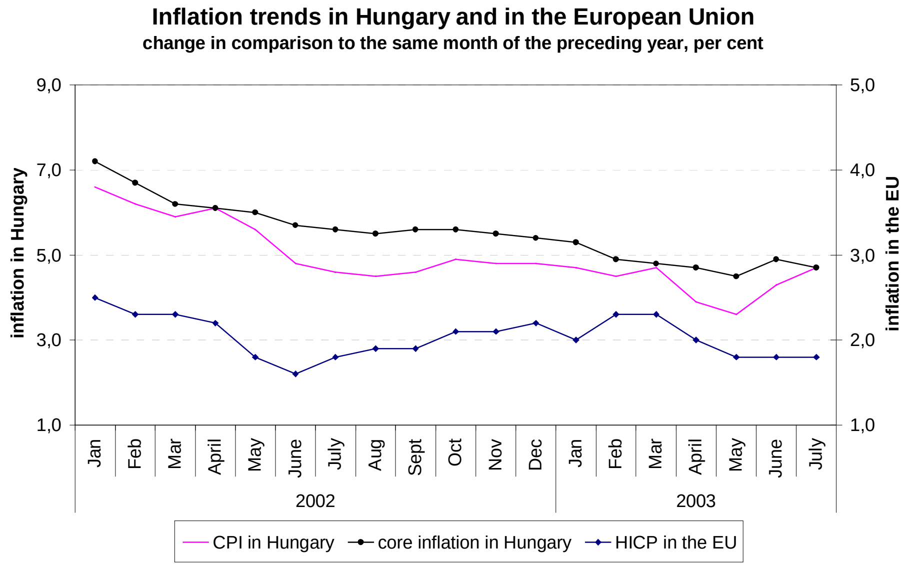
In accordance with our forecasts and based on CSO figures, the inflation showed signs of a turnaround in trend. The 12-month rates began to increase after the fast disinflation supported until May by seasonal motives as well. Strong seasonal influence is showed by the development that core inflation, to measure fundamental price changes, was much more balanced. In July, the rate of inflation continued to rise. The inflation must be really expected to accelerate in the second six months of the year in line with the weaker Hungarian Forint, some changes to administered prices and increasing agricultural prices.

Annual rate of inflation to drop in 2003

In overall terms, inflation will drop even in 2003 compared to the previous year with about 4.8 per cent on an annual average basis.

In an environment with lower inflation, more apparent is the re-arrangement of relative prices as evidenced both in price increases to a various extent of products and market services and in administrative price increases.

Core inflation similar to CPI



Major factors of inflation can be disclosed in going thoroughly into certain groups of consumer basket. For foodstuff and non-alcoholic drinks, it was experienced from June that the agricultural prices (producer prices of plants and vegetables) began to slowly increase to exceed by 1.1 per cent in July the averaged price level a year earlier. A slow price was felt for meat products as well, however, the prices were lower than had been a year earlier. Based on the processes, the meat products may see a price increase of 1 to 3 per cent on an annual basis. The price increase of beverages and tobacco products was due to higher producer costs and changes to excise taxes. In this category, prices increased by 8.4 per cent and 12.8 per cent (measured on December 2002) until July and during 12 months, respectively.

Moderate price increase of foodstuff; excise tax on cigarette increased

Clothing goods and footwear is a typically seasonal category. The monthly price fluctuation was significant, and the 12-month rates were generally below 3 per cent. Thus, a similar figure is expected for the whole year.

Disinflation is most marked for industrial goods. For durables, the statistics registered nominal drop in prices in a couple of cases. Behind the price increase of motor vehicles, there stood particularly the weakening national currency, typically from June.

Low inflation of industrial goods

The housing services were more expensive above the averaged inflation due particularly to the price increase of pipeline gas that appeared in the price index of July. In addition, price increase of repair and maintenance services with market-based pricing as well as communal services (such as waste delivery and sewage drain in particular) was above the average. For the year as a whole, price increase above the average is likely the extent of which is, however, dependent on the inclusion of gas price subsidy. In the category of Household Contents and Equipment, averaged price increase of services, below-the-average increase or even decrease for durables and expendables as well as sundry manufactured goods all formed the price increase below the average. The annual average here is expected around 1 to 3 per cent.

Service charges related to housing more increasing while product prices increase slowly

Market services prices have increased above the average permanently. It is especially the case where the service concerned has no substitute or rival by nature and/or in the local market, or where the increased purchase power would permit more significant price increases to be effected. The difference between the rate of price increase of services and manufactured goods is considered steady.

Services have been more expensive above the average

In the field of Healthcare, the weight of medicines is determining. The latter produced a price increase of 5.7 per cent during 12 months through July (and also from the beginning of the year). For the whole product category, the same rate is indicative at about 6 to 7 per cent.

Price increase of medicines slightly above the average

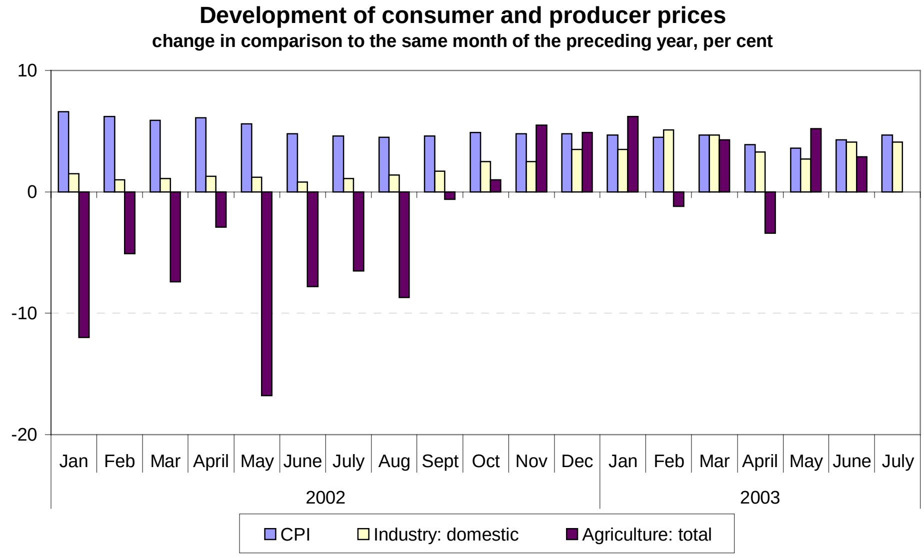
In the category of Transport, lower price increase of motor vehicles and parts or sometimes falling prices thereof, fast price increase of services in relation to operation and maintenance, moderate price changes of local and intercity transport as well as rather volatile changes to fuel prices were typical. Accordingly, the level of fuel prices went up and down from December to March of 2002, and then to July by 8.3 per cent and 5.7 percentage points, respectively.

For Telecommunication, phone-related services had a moderate price increase below the average. This trend is assumed to be effective for the whole year. In the field of recreation and culture, repair-related services were more expensive; prices of purchasable equipment and devices lowered while significant price increase was made for books, magazines and newspapers. Also, recreation and cultural services were significantly more expensive. In overall terms, about an averaged price is expected for the year as a whole. The category of Education's price increase at over 10 per cent is considered permanent. The Restaurants and Hotels’ price increase fell a little (from 10.7 per cent in December 2002 to 8.9 per cent in July 2003). Future developments are subject to wage costs and purchase power in combination. Among Miscellaneous goods and Services, the outstanding and high price increase of insurance and other financial services should be highlighted, in addition to hairdressing and body care services.

Prices of books, newspapers significantly rose; market services prices increased above the average

Significant differences were experienced for price development of productive sector.

Characteristic fluctuation for agricultural producer prices



Agricultural producer prices at last year's level

In the first six months of the year, agricultural producer prices were 0.4 per cent left below the same period of previous year. At the same time, for plants and vegetables the price increase was 3.66 per cent on the average (1.1 per cent excluding fruits and vegetables). For animals and animal products, averaged price level of the first six months was 6.0 per cent lower than measured a year earlier. In this context, positive indices of slaughter-calves and cattle as well as of the milk were different from the general falling trend. In Hungary, agricultural prices are rather volatile, however, it is likely that a more significant price increase must be expected in the second six months, for plants and vegetables above all.

Domestic industrial producer prices increased faster than last year, following energy prices in particular

In the first six months of 2003, domestic industrial producer prices largely exceeded those a year earlier, particularly in energy sector. For the sectors producing for further use or those manufacturing durable consumer goods, the increase was not so fast. For the sectors manufacturing investment goods, a permanently low pace of price increase, which was even slower than the 2002 figures, due to business cycle reasons most of all. For 2003, a price increase of about 4 per cent is expected based on the forecasts concerning international price trends and domestic economic upturn. After the fall in 2002, export selling prices in HUF terms increased and expected to further increase.

Change to business cycle in construction reflected in prices

The cost-based producer price index was 106.4 per cent in construction in June of 2003 while it moved between 104 and 105 per cent in the preceding months. The price increase was 105.2 per cent on the average of the first six months, representing pace increase from the last year.

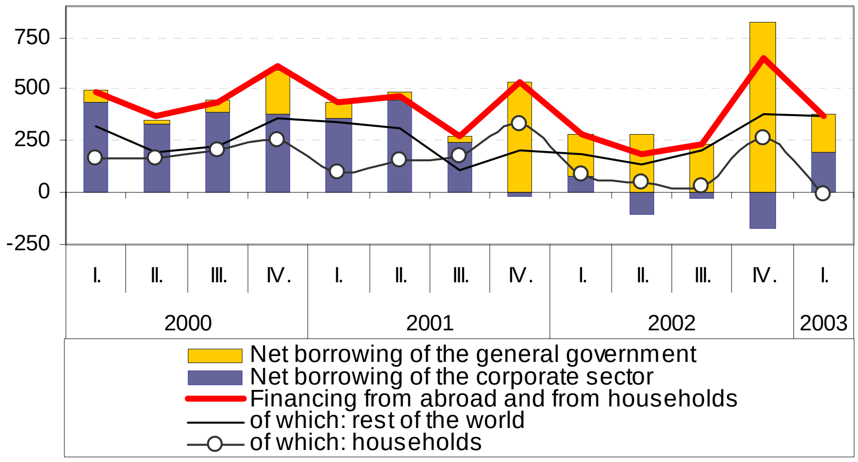
5. Income and financial flows. Equilibrium

5.1 Equilibrium factors

Concerning net financing requirements/capacities of economic sectors, there are the first quarterly financial accounts available. In particular, the national economy's external financing requirement amounted to the same extent in the first quarter of 2003 as had been in the fourth of 2002 (HUF 382 billion). Behind the increased external financing need, structural changes to internal processes were found. The general government net borrowing contracted, especially if compared to the last year's fourth quarter with very high financing requirement. However, the households' net financial savings showed a negative figure (HUF -8 billion) due to the loan portfolio strongly increased, and it had never seen before since 1998 when the time series available in a comparable structure was implemented. After taking a net saving position last year corporate sector started to borrow in Q1 in accordance with our former expectations. (Financial and non-financial enterprises in total: HUF -195 billion).

It is structural changes to internal processes behind the increased external financing requirement

Financing requirement / capacity of sectors (HUF, billion)



Only partial information are available from the processes of the second quarter suggesting that net financing requirement of enterprises continued to grow while borrowing of households has not slackened. Therefore, it is not excluded that households' net financial savings was negative in the second quarter as well.

Increasing role of external financing

Based on cash-flow figures, government deficit (excluding local governments) increased somewhat in the second quarter (HUF 319 billion vs. HUF 282 billion). As a result, external financing of the national economy has increasing role, also indicated by the worsening trend of current account.

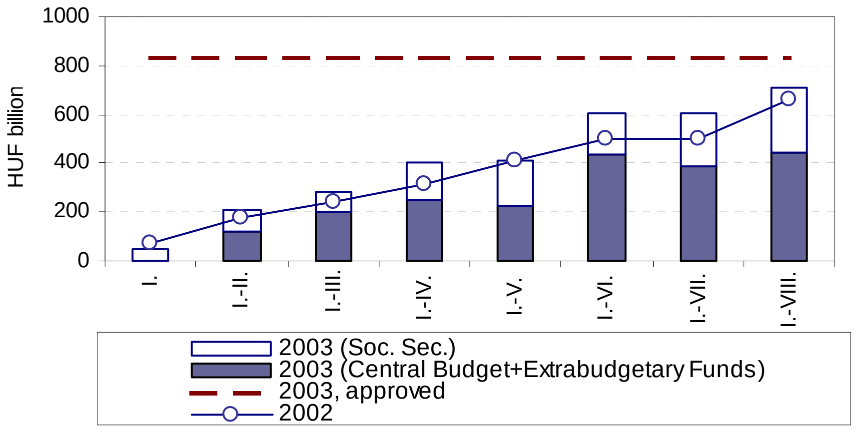
Although in the second six months of the year, due to aggravation of credit terms, the households are expected to be in net savings position for the whole year households savings will not even achieve the last year's low level. Under increasing corporate financing requirement and low level of household savings, the national economy's external financing need is expected to grow even despite the fact that general government borrowing would be less in 2003 than had been a year earlier. In case the current trends continue, only decrease of general government net borrowing can help external financing requirement to be kept within sustainable limits.

5.2 General government

Central government deficit achieved 85 per cent of the annual appropriation by August-end

Based on preliminary figures, central government deficit[3] (excluding local governments) increased somewhat below expectations by HUF 106 billion. The deficit from January to August was HUF 708 billion or 85 per cent of annual appropriation. The central budget deficit was HUF 481 billion (84.6 per cent); the social security funds had HUF 262 billion in deficit (or 94.5 per cent of annual appropriation) while extrabudgetary funds run a surplus of HUF 36 billion. Until last year's August-end, the central government deficit exceeded by almost 30 per cent the annual appropriation, or HUF 659 billion made up 42 per cent of annual fact (or 63.5 per cent excluding the year-end debt assumptions and debt forgiveness).

Government deficit (without local governments)



After the significant growth in June when the biggest monthly deficit (HUF 192 billion) emerged in the year to date, in July the deficit went up by almost HUF 1 billion only. The amount of HUF 106 billion in August was less than formerly projected on the basis of seasonal characteristics of previous years.

[3] Interim data present government without local governments, on cash basis.

Performance rate of expenditures ...

The central government's revenues in fact, aggregated from the beginning of the year, somewhat left behind the timely pro-rata figure in every month to date, but even so, the performance rate was more favourable from time to time than had been in the same period of 2002. The difference increased almost to 4 percentage points by August. At the same time, the performance rate of expenditures was in every month except May higher (by an averaged 0.5 percentage point) than pro-rata share of annual appropriation, exceeding by 1.2 percentage points that of the revenues. The gap between the performance rates of revenues and expenditures was 2 percentage points at August-end.

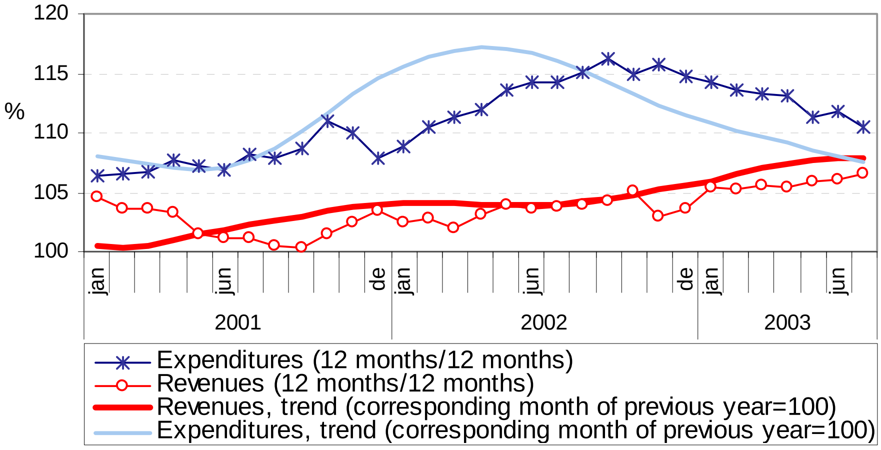
Detailed figures are only available for the first seven months. Accordingly, the consolidated primary revenues of the two major subsectors of central government, namely the central budget and social security funds (excluding transfers between the levels of government and own revenues of central budgetary institutions which contains transfers to each other of a significant size), increased by 13.2 per cent (8.4 per cent in real terms[4]) compared to the period of January to July 2002. Within this tax and tax-related as well as social contribution revenues rose by 8.2 per cent in real terms.

... and growth rate of those still higher than that of the revenues

Growth rate of expenditures decelerated compared to the first months of the year but still more dynamic than that of the revenues. Consolidated primary expenditures of the central budget and social security funds from January to July increased by 14.2 per cent (9.4 per cent in real terms) compared to the same period of 2002. 'Rolled' indices showing the change on the previous 12 months as well as the indicator of trend changes displayed until July that the gap between the growth rates of revenues and expenditures narrowed, notably the growth of revenues accelerated while that of expenditures decelerated. (In the rest of the year, compared to the increasingly high last year's basis, the growth rate of expenditures will further decelerate, excluding debt assumptions and forgiveness at 2002 year-end for comparison purposes.)

[4] For the calculation of real growth, the consumer price index was used as deflator, even if the logic of economics would have justified another indicator (e.g. GDP deflator) since only for the consumer price index there are interim (monthly) figures available.

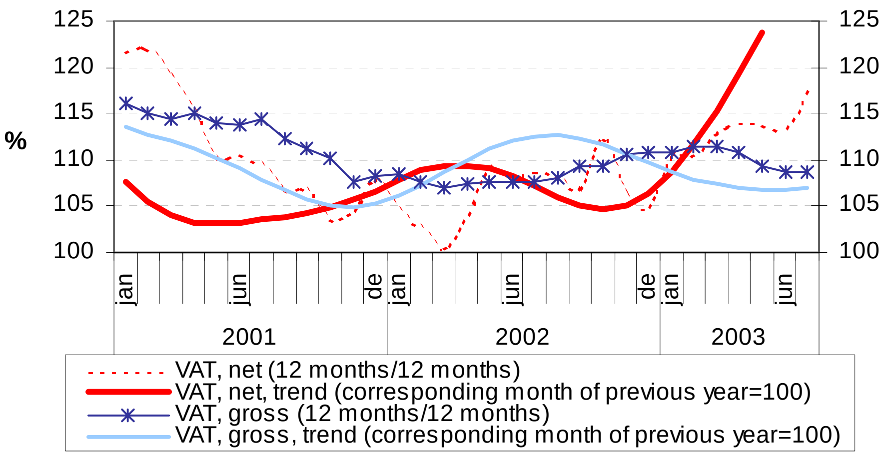
Consolidated primary revenues and expenditures (Central budget and social security, changes in real terms)



VAT revenues increased strongly…

In detail, VAT revenues having the greatest weight among central budget receipts were realised at 64 per cent of the related appropriation exceeding by nearly 6 percentage points the timely pro-rata figure and more than 3 percentage point the last year's ratio. VAT revenues rose almost 28 per cent (more than 22 per cent in real terms) compared to the same period of 2002. "Rolled" indices of changes from the previous 12 months indicate a significant acceleration of revenues. The amount of net VAT revenue appearing in the central budget must be influenced by the fact that the rate of refunds showed greater fluctuation than the seasonal effect accustomed in the recent years. However, in July gross VAT revenues strongly (15 per cent) increased as well. The index of change relative to the pervious 12 months seems to be stable from 8 to 9 per cent.

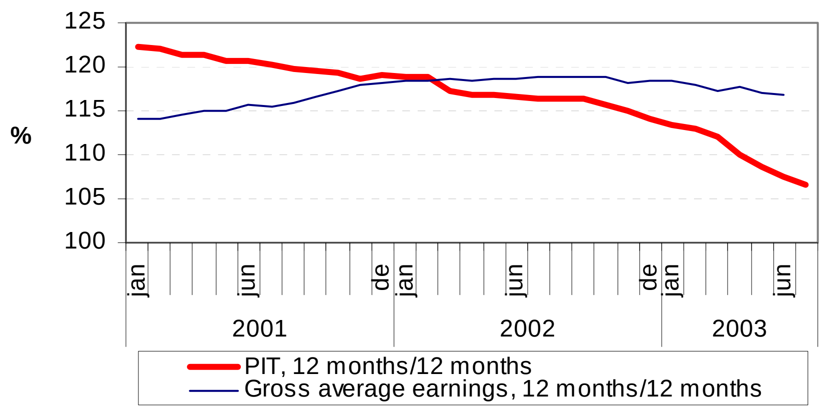
Development of VAT revenues



The revenues at general government level from the personal income tax with the second largest weight were realised at lower ratio from April than both the pro-rata and last year's figures. In the first seven months, the annual appropriation realised at 55.3 per cent against 58 per cent from January to July 2002. Revenues increased much more slowly than gross average earnings (less than 3 per cent until July-end compared to the same period last year) as a result of changing tax rules as well as higher tax refunds in relation to 2002 tax accounts. The difference between growth rates was presented in the "rolled indices" showing the change from the previous 12 months.

… but receipts from personal income tax have increased slower

Development of PIT revenues



The 7-month revenue from personal income tax appearing in the central budget was more than HUF 25 billion left below the last year's figure explained by the increase of transfer share due to local governments, in addition to lower growth rate.

The increase of receipts from social security contributions was 10.6 per cent from January to July 2002 to meet roughly the pro-rata share of annual appropriation. The performance rate of contributions in the relevant period surpassed by 0.6 per cent the last year's figure.

The amount of receipts from contributions was satisfactory

Among major expenditures of central budget, the central budgetary institutions' spending covered by transfer as well as social subsidies did not achieve the pro-rata measure until July-end while transfers to local governments significantly exceeded it. The biggest excess was seen for housing subsidies where annual appropriation was spent in 93 per cent. The amount of subsidies to economic organisations also surpassed the pro-rata figure. Interest expenditures exceeded by 5.5 percentage points the pro-rata figure.

Spending in excess of some appropriated expenditures

Among social security expenditures, the health insurance benefits in cash and in kind (sickness benefit, maternity benefit, health services, pharmaceutical subsidies), in line with the former months exceeded the pro-rata figure for seven months.

Including savings on spending apr. 0.4 per cent of GDP, the deficit may be 4.8 per cent of GDP

The budget law for 2003 provided for general government deficit on ESA95 basis (including local governments) as 4.5 per cent of GDP or HUF 840 billion. Being aware of the processes of the first months of 2003, the Government decided early in June on saving HUF 76 billion (about 0.4 per cent of GDP) of appropriated spending. The relevant measures by blocking the appropriations of transfers at 2.5 per cent to central budgetary institutions; reviewing remaining appropriations of institutions and modifications of housing subsidy system contain the deficit growth. Including the effects of the measures above, general government deficit for 2003 is likely at 4.8 per cent of GDP (though it is not to be excluded that the excess of deficit may even be a few tenth of a percentage point higher).

On the revenue side, no leeway is likely in overall terms. The excess revenues from corporate tax, simplified tax for enterprises (SMEs) as well as VAT and contributions could compensate for the revenue shortfall of personal income tax. Risks are rather on the expenditure side where housing subsidies, family allowances (such as those for women on maternity leave based on the decision by the Supreme Court), interest paid, pharmaceutical subsidies may well be excessive. The growth of spending of remaining appropriations of budgetary institutions may influence the scale of deficit.

The government budget for 2003 earmarked **public debt** growing more slowly and bringing down deficit in light of which the Government determined net financing needs as HUF 832 billion or lower than had been in 2002. In the calculations of Government Debt Management Centre, net financing need of the general government budget will make up HUF 897 billion or HUF 65 billion higher than originally planned.

In 2003, three principles are to guide the debt management strategy:

- Government budget deficit is financed from the domestic money and capital market.
- Matured HUF debt is domestically renewed in Hungarian Forint while foreign exchange funds provide for FX debt to be renewed.
- Stability and level maintained on Single Treasury Account (KESZ) guarantees the secure financing.

Conditions for financing government debt seem mixed in the period since the latest Flash Report. At May-end or early June, due to the adverse yield level in the government securities market, the Debt Management Centre sold less government securities than planned. The June-end low position of Single Treasury Account and the government budget balance worse than planned determined the financing situation in July to August. As a result, the Debt Management Centre was forced to raise its securities issues despite of increasing yields which was due to the fact that the National Bank of Hungary increased the base rate and market expectations were worsening.

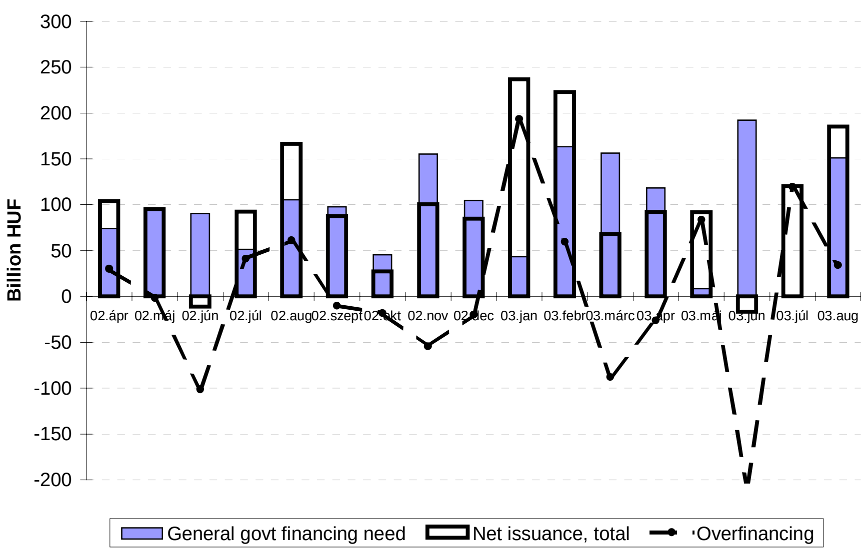
Situation stabilized in the market of government papers

On an annual basis, proper coverage was in place both in the markets of government bonds and T-bills although mitigated demand by foreign investors markedly appeared in the coverage ratios following the shift in fluctuation band. Most secondary market transactions continued to be realised in the OTC market.

In June, a syndicated loan of EUR 500 million was made, which was used for the early repayment of debt elements with harsh conditions assumed in December of 2002. Moreover, the Debt Management Centre will implement a bond issue of EUR 1 billion in the year with a term of 7 years.

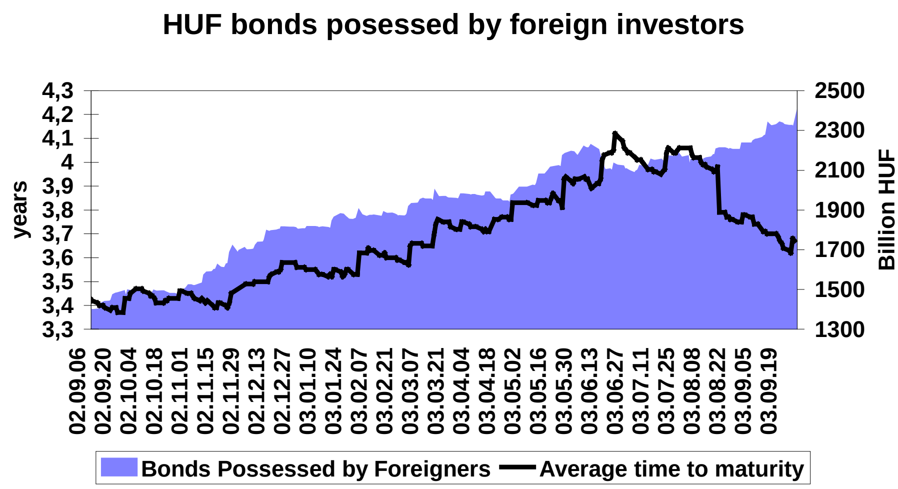
Overall, it is established that general government financing was balanced in the first eight months of 2003 except for January and June when significant overfinancing and underfinancing were made, respectively.

Borrowing need and net issues



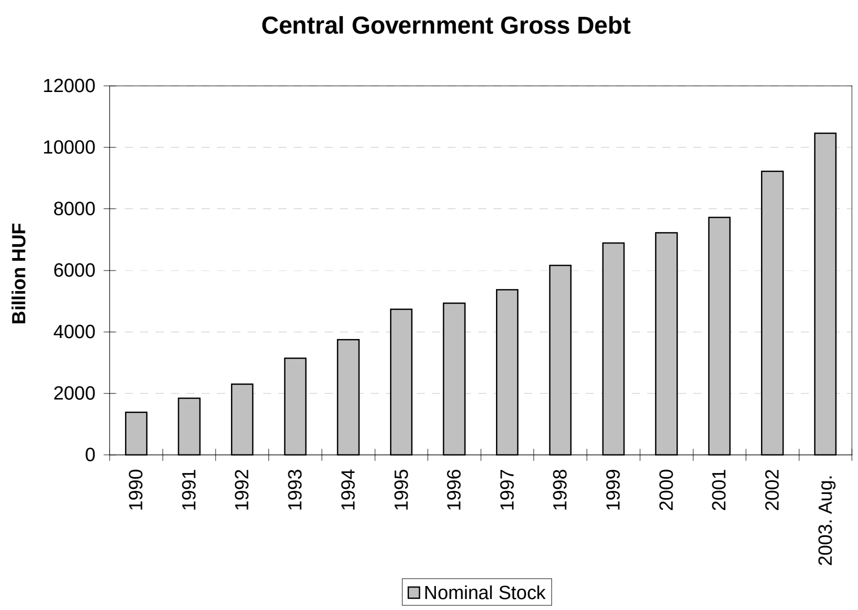
Foreign-owned government securities on the rise after going down

Fluctuation of foreign-owned government securities was significant since June. At May-end government bonds held by non-residents increased dynamically in line with former tendencies. Foreign participation was dominant in the demand for government papers. On June 2, their stock exceeded HUF 2200 billion. However, selling transactions were continuous in the wake of the shift in fluctuation band since the weakening national currency and increasing interest rates created an adverse situation for the owners of government papers while new buyers stayed away from the market of government papers due to market uncertainty. After the stabilization of the situation, foreign investors' activity revived and their stock of government securities resumed to grow. This stock was raised to HUF 2230 billion by the end of August. The growth of non-residents' government papers was implemented under the escort of the average term to maturity being shortened by almost 3 months. That is, they wanted to reduce the risk by curtailing maturity, rather than by selling their papers.



Central government debt in gross rose by 12.6 per cent to HUF 10389.13 billion by the end of July from December 2002. Bringing down the government debt and budget deficit relative to GDP is still a very important objective of the economic policy. The Hungarian government debt in percentage of GDP has fallen in each year since 1993 except for 2002 while being below 60 per cent even the Maastricht criteria has been met since 1999.

A very important objective: to bring down government debt and budget deficit relative to GDP

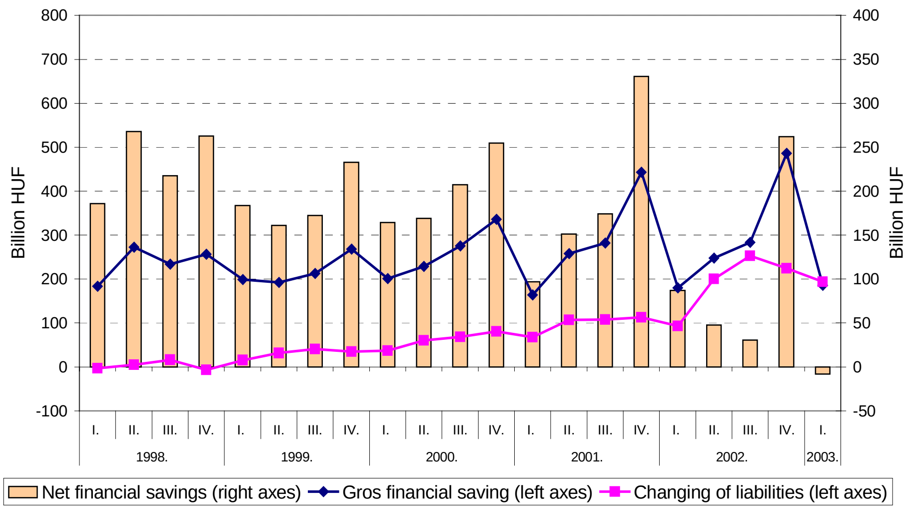


5.3 Households' financial savings

Based on the statistics of national accounts, it was the first time for seven years to register a quarter in which *the households' sector acted as to require financing* from other sectors. The households' net financing capacity[5] of HUf -7.9 billion in the first quarter came partly as a result of low savings in gross due to seasonal effects or, in particular, of change to loan portfolio still in dynamic expansion. Operational transations[6], which are the most indicative of the households' decisions for consumption and accumulation purposes, disclose the processes in place more markedly since for these aggregates, the increase of financial liabilities exceeded by more than HUF 57 billion the increase of households' financial assets.

Households appeared to require for financing from other sectors. In the background, continued dynamic growth of real estate-related lending or seasonal effects

Development of the financial position of households
from 1998 (new methodology, transactions)



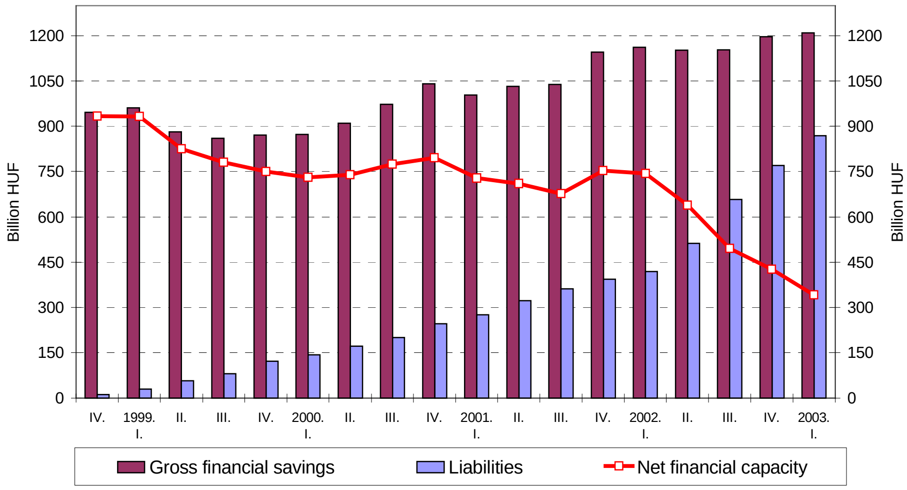
Due to the transactions in the first quarter of 2003, the households enlarged their financial assets by more than HUF 185 billion added by further HUF 108 billion from revaluation due to exchange rate modification. The sector's 12-month savings in gross (increase in assets as a result of transactions) was stagnant since the year-end of 2001, thus a dynamic expansion of loan portfolio continued to determine the households' net position. The fast run-up of liabilities registered since 2001 resulted in continuously and shortly (during a year and a half) unbuilding the households' annual net financing capacity. The present 12-month value of it is HUF 333.2 billion or hardly 44 per cent of that in the end of 2001.

Averaged enlargement of the households' financial assets while some instruments had a sensible respond to volatile interest rates

5 The households' net financing capacity is the difference between the changes to financial assets and liabilities in a given period as a result of transactions. Transactions of a given period include operational transactions or the interest compensation for inflation.

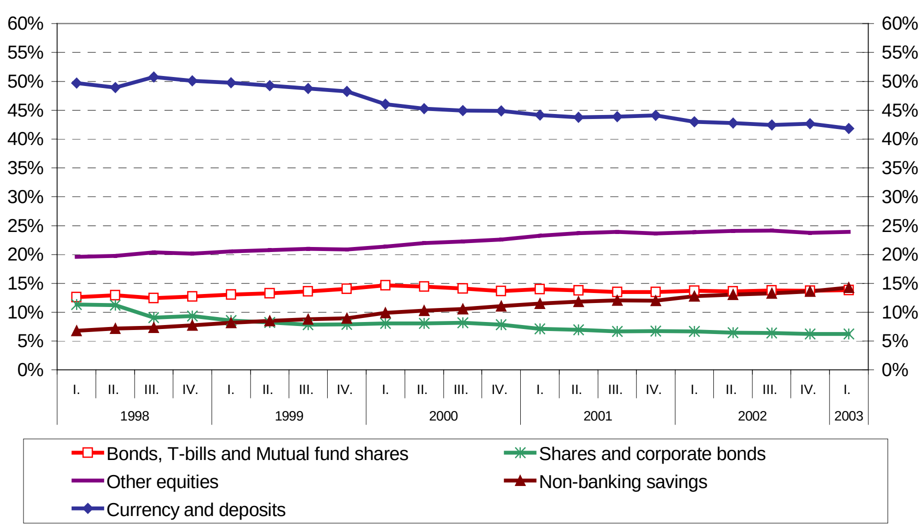
6 Operational transactions come as a result of the change to assets and liabilities during a given period of time adjusted for revaluation due to exchange rate modification, interest compensation for inflation and other changes to volume.

Development of the financial position of households
(1998-2003, new methodology, 12 months accumulated values)



Although the first quarter increment of financial assets is corresponding to the typical figures in this phase of the year as usual, unexpected changes appeared due particularly to monetary events. As a result of very volatile yields, the households-held discount T-bills strongly fell (HUF -47.8 billion). Hectic behaviour of government securities market could also contribute to the dynamic growth of investment notes (HUF +102. 4 billion) while purchasing shares in a business continued to be considered very popular form of savings even by international standards. In line with tendencies formerly started, non-banking forms of savings continued to gain ground. The share of 'conservative' financial assets remained fairly high.

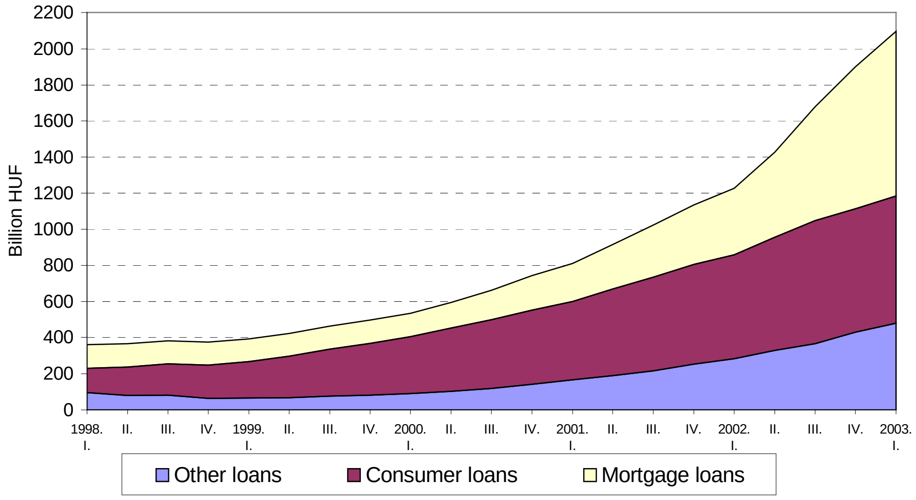
The structure of households' financial assets



Based on structural changes to the loan side, real estate-related lending with far the greatest growth rate caused the indebtedness upsurge. The change to real estate loans due to transactions was some HUF 124 billion or almost four times the figure of the last year's same period. While the increment of consumer loans was lower than had been in the first three months of 2002 the portfolio of other loans essentially rose (typically leasing liabilities related to car purchases with increment of more than HUF 50 billion due to the transactions).

Real estate-related lending to determine liabilities

The development of household's liabilities
1998-2003



Shrinking net financing capacity of households is deducted from Hungary's emerging economic status of transition. The processes of the recent period suggest however such a fall that must make a bad impact on the country's equilibrium, growth outlook and the success of disinflation. A key variable should be to the efficiency of economic policy decisions in the future how much internal ratios of consumption and accumulation can be changed.

Overall, negative financing capacity characteristic of the first three quarters of 2003 while any improvement is expected only in the last months of the year

In the first six months, the households can still receive housing loans under preferential loan facilities. Therefore, housing loans are expected to drastically run up possibly resulting in further rise in the sector's financing needs in the first six months of the year, or - due to the carryover of disbursements - early in the second six months of the year as well. The improvement of financing capacities or turning positive is not expected but in the last months of the year while the 12-month ratio is estimated to 0.5 to 1.5 per cent of GDP at year-end.

5.4 Corporate sector

Turnaround in funds involvement by the corporate sector

Based on the data of national economy financial accounts, the corporate sector became again net debtor in the first quarter of 2003, despite the adverse business cycle; the corporate leverage resumed to rise.

Development of corporate sector's* position according to the financial accounts

	2002.Q1	2002.Q2	2002.Q3	2002.Q4	2003. Q1
Non-financial corporations**	-73,0	127,7	-26,2	274,8	-261,6
Other financial corporations	-36,7	-5,9	47,0	-38,0	-8,5
Total	-109,7	121,8	20,8	236,9	-270,0

*without credit institutions
**other financial intermediaries+financial auxiliaries+insurance companies, pension funds

Funding demand by corporations further increased in the second quarter

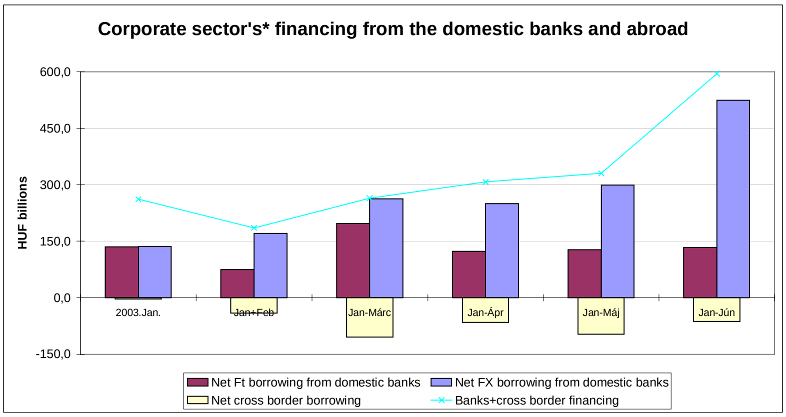
Distribution figures of main financing and investment sources suggest a smaller growth of funds involvement. (Compilation of financial accounts for the second quarter was not yet prepared.)

The **reversal of diminishing trend of foreign funds involvement** also confirms the abovementioned assumption. Debt-related funds involvement began to grow with the exception of intercompany loans. Because foreign direct investment (FDI) started to rise again from May, the total foreign funds involvement increased by HUF 42 billion.

The enterprises' **net indebtedness to domestic banks increased by almost HUF 200 billion in the second quarter**. The increase came as a result of the growth of net foreign exchange debt, mostly and assumably related to the imports of manufacturing investments.

The combined stock of **government securities and investment notes** in business sector increased by HUF 142 billion in the second quarter. Purchasing investment notes was stopped almost entirely. Discount T-bills fell very largely. Thus, the growth was in practice a consequence of the investment in government bonds the most part of which went to insurance companies and pension funds.

As a result, enterprises acted in the quarter to raise **a financing need of almost HUF 100 billion in net**. The further increase of enterprises' financing needs should refer to further strengthening activity by the enterprises.



5.5 Balance of payment

The deterioration in the **current account positions** had started when trade deficit still went down and economic slowdown appeared only in declining a formerly fast dynamics of turnover (including both exports and imports). Then, it was particularly the strongly worsening balance of services to increase current account deficit, which could be financed comfortably through FDI (the balance started to go wrong in the last quarter of 2001).

Current account deterioration was previous to trade imbalances

In the last third of 2002, while the trade balance still improved against the previous year in terms of cumulative figures, decelerated export pace and accelerated import pace increasingly deteriorated the monthly export-import balances, the pace of monthly imports usually exceeded that of the exports. However, as a result of the former 'positive' gap, it was only in the beginning of 2003 that the above-mentioned trend appeared in the cumulative figures. Therefore, the deterioration of the trade balance increasingly contributed to the deterioration of the current account positions in the last 10-12 months.

Growth rate of imports step by step overtook that of the exports

The line in the current account in relation to trade in goods showed a deficit of EUR 1.6 billion in the first six months or this deficit was EUR 900 million higher than had been in the same period of 2002. (As a result of different time and approach of data logging, the trade balance statistics took into account somewhat higher turnover and apr. EUR 100 million higher deterioration in the balance, that is, a deficit growth of EUR 1 billion compared to the first six months of 2002.)

Deficit on payments of trade in goods EUR 900 million above last year

The balance of services had been EUR +240 million a year ago. (It was a modest surplus but a surplus.) By the end of June 2003, this surplus turned into a deficit of EUR 75 million of which declining surplus of tourism made up EUR 150 million due crucially to falling (220 millions) revenues (expenditures also fell). Revenues from tourism have been falling for a longer time all over the world for various reasons similarly to the deterioration of Hungarian balance of tourism.

The main cause of deterioration in the balance of services – the recession of tourism

The decline in tourism was largely to adverse outlook for economic upturn, and the fears of terrorist attacks in the wake of the tragic events of September 11, 2001 as well as to local wars with much higher publicity than formerly. Services other than tourism have produced a deteriorating balance for a longer time largely because of services related to trade in goods, i.e. caused by the deteriorating trade balance.

It was first in a longer period in June that revenues from tourism increased. Until the year-end, the result of tourism is estimated not to worsen. The balance of other services has also been deteriorating for a long time, particularly for technical and cultural services. A better balance on the merit is first of all expected from higher rates of tourism.

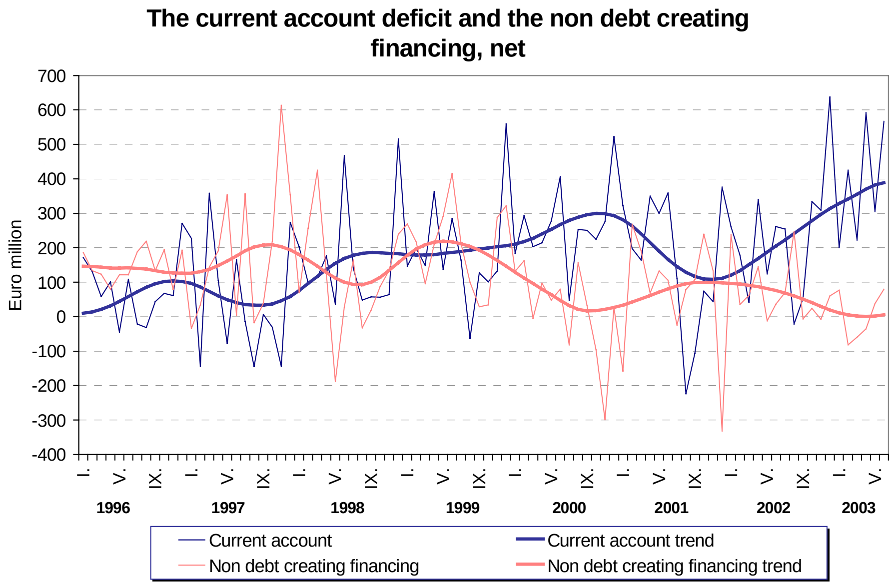
Mainly the lower balance of profit repatriations behind a better balance of incomes

In the balance of incomes, the modest and falling surplus of earned income was not determining. Profit-related income and interest brought the most part of this 'line'. In relation to indebtedness, the usually negative balance of interest paid and received increased by EUR 60 million (amounting to EUR 524 million) while profit repatriations fell by EUR 170 million due partly to pull-out of some investors, and partly to diminished revenues of foreign enterprises. That was what enabled the income deficit to be cut off by EUR 85 million in particular.

Unrequited transfers improved by EUR 50 million further mitigated the deterioration of the balance of trade in goods and services.

Deterioration of current account above EUR 1 billion

Even so, the current account deficit worsened by EUR 1.1 billion, making up EUR 2.3 billion.



Indebtedness with a greater role in financing deficit

FDI import falling while capital outflow increasing

FDI inflow or the balance of capital account were less than usual capable of financing the current account deficit. While the balance (with surplus) of foreign capital inflow (investments) in Hungary fell by EUR 250 million to EUR 250 million, capital outflow from Hungarian enterprises increased by EUR 450 million to almost EUR 500 million. Although, in a long-term perspective, the positive result of the latter is unquestionable, the overall negative effect of almost EUR 700 million deriving from capital movements could not be offset by the increasing portfolio investments of EUR 200 million but limited to apr. EUR 500 million (EUR 485 million). On the whole, the non-debt-generating financing that had accounted for financing more than 40 per cent of the current account deficit in the same period of 2002 practically stopped. The key problem of increasing debt is its government-related nature. That is, the growth of deficit is not attributed to the enterprises' development activity or more intensive investments since in the latter case, the conditions of accelerating production and export growth would be established at the same time.

In sum, without underestimating the problem of increased current account deficit, it should be noted that Hungary's balance of payments was very rarely positive in the past either (and even so and then, it had not been necessarily favourable for general economic conditions, e.g. between 1990 and 1992). Also, the current account is not but very rarely used to improve from one year to another in absolute terms (between 1995 and 1997 and in 2001). If in addition, its ratio to exports and/or the GDP is decreasing there is no serious problem. Between 1998 and 2000 when the national economy went on a favourable growth path, the current account positions significantly deteriorated. (Behind that there were import needs of an expanding production and exports laying the foundations of a robust export offensive implemented for several years.) A number of years of vigorous export growth were needed in order that the current account balance improve as well. Now it is a cause of concern that the nature of deterioration is different. For a more favourable state of equilibrium to be achieved, the capabilities of alluring foreign capital and suitabilities for export should improve. If these conditions are met even an increased current account deficit could not cause significant problems.

Current account deficit may be lower in the second six months

In general, the current account deficit used to emerge in the first six months on a larger part (with only one exception of 2001 within the recent 8 to 9 years; in 2002 the current account deficit arose in half in the first six months). This year, the current account deficit is estimated to be somewhat lower in the second six months (also underpinned by the last year-end's lower export and higher import reference).

The amount of current account deficit, and that of indebtedness are not comparable to the former debt-increasing processes since the order of magnitude of GDP and particularly of the export as a reference for this financing gap is extraordinarily higher than had been in the 80s. On another hand, there is a significant structural difference as well because an essentially higher share of exports is to move in full conjunction with the imports (that is, the imports are realised only if the export is implemented with the big international companies). Therefore, the risk of overruns in imports in relation to exports is well below the former one. While consumption is more import-intensive than before but representing a minor share of imports now. At the same time, the growth of investments and their increasing imports (due just to the considerable weigh of big enterprises) are faster to appear in export growth as well.

Indebtedness is not comparable to former periods

Our following Flash Report will present the latest debt figures as to be published by the National Bank of Hungary.

Budapest, 10 September 2003

T A B L E S

Table 1.

ECONOMIC INDICATORS

Real Sector, Prices, Competitivness

change from the same period of the previous year, %

	1999	2000	2001				2002									2003						
	I-IV. quarter	I-IV. quarter	I. quarter	I. half of year	I-III. quarter	I-IV. quarter	I. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month	I-III. quarter	I-IV. quarter	I. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month
GDP volume	4,2	5,2	4,2	4,1	4,0	3,8	-	-	2,9	-	-	2,9	-	3,1	3,3	-	-	2,7	-	-	2,6 *	-
Household consumption	4,8	5,0	6,1	6,0	5,5	5,3	-	-	8,2	-	-	7,9	-	8,4	8,8	-	-	8,1	-	-	-	-
Gross fixed capital formation	5,9	7,7	4,5	3,5	3,4	3,5	-	-	8,6	-	-	6,5	-	6,0	5,8	-	-	-1,2	-	-	-	-
Exports of goods and services	12,4	21,0	18,7	15,8	13,3	8,8	-	-	4,5	-	-	5,3	-	4,6	3,8	-	-	3,2	-	-	-	-
Imports of goods and services	13,3	19,4	17,5	15,1	10,4	6,1	-	-	4,4	-	-	4,6	-	5,5	6,1	-	-	5,3	-	-	-	-
Volume of retail trade turnover 14/	7,9	2,0	7,2	6,2	5,8	5,4	15,1	13,1	14,5	13,6	13,3	13,3	12,5	11,4	10,7	12,5	10,4	9,1	10,1	8,9	8,3	-
Volume index of investments	5,3	6,5	5,3	4,2	3,7	3,5	-	-	8,6	-	-	6,4	-	5,9	5,8	-	-	-1,2	-	-	0,6	-
Foreign trade turnover 1/: export volume	15,9	21,7	18,2	15,8	12,4	7,8	3,7	4,7	5,4	6,9	6,5	7,0	7,8	7,6	6,8 /12	5,8	1,5	2,4	1,8	1,5	1,8 *	0,0
import volume	14,3	20,8	16,6	14,2	8,8	4,0	1,9	3,9	3,3	4,4	3,5	3,8	4,7	5,2	6,1 /12	2,4	2,5	4,4	5,5	6,5	7,1 *	0,0
Volume of industrial production	10,4	18,2	10,3	8,0	4,7	3,6	-5,1	-1,8	0,0	1,2	0,0	0,7	1,9	2,3	2,8	4,5	2,5	4,0	3,6	3,8	3,9	4,1 *
Volume of construction-installation activities	8,3	7,6	6,9	8,1	9,3	8,3	8,5	17,0	25,1	27,4	26,2	23,4	21,9	20,3	17,8	3,5	-10,5	-14,6	-13,0	-7,9	-3,8	-
Number of employees (in thousands)																						
household survey (annual average)	3811,5	3849,1	3851,6	3850,7	3863,0	3859,5	-	-	3840,0	-	-	3853,8	-	3864,6	3870,7	3862,4	3847,5	3859,6	3872,8	3878,5	3891,8	3896,3
labour statistics 2/	2691,4	2718,1	2712,3	2719,7	2723,3	2720,8	2698,7	2701,9	2705,0	2708,3	2711,5	2714,5	2716,9	2720,9	2726,1	2716,0	2722,2	2724,3	2729,8	2735,5	2740,3	-
Vacancies (in thousands) 3/	42,6	39,2	45,4	50,0	51,1	37,3	37,6	45,2	47,3	44,0	47,5	48,6	47,9	49,8	34,0	31,9	37,7	42,7	47,7	-	-	-
Number of unemployed (in thousands) 3/	404,5	372,0	399,2	359,6	344,6	342,8	368,2	381,1	368,2	348,8	334,4	328,5	334,4	334,2	344,9	374,3	388,3	386,2	368,6	-	-	-
Rate of unemployment (household survey, %)	7,0	6,4	6,0	5,8	5,7	5,7	5,8	5,9	5,8	5,7	5,7	5,7	5,8	5,8	5,8	6,6	6,5	6,4	6,3	6,2	6,1	6,1
Consumer price index	10,0	9,8	10,3	10,4	9,9	9,2	6,6	6,4	6,2	6,2	6,1	5,9	5,7	5,4	5,3	4,7	4,6	4,6	4,4	3,6	4,3	4,4
Index of industrial domestic sale prices	7,2	14,5	12,7	12,3	11,0	9,4	1,5	1,3	1,2	1,2	1,2	1,2	1,2	1,2	1,6	3,5	4,3	4,4	4,2	3,9	3,9	4,0
Index of industrial export sale prices	2,8	8,5	7,0	4,9	3,0	1,5	-4,8	-4,9	-5,2	-5,4	-5,2	-4,8	-4,5	-4,3	-4,5	-3,1	-2,7	-2,4	-2,4	-2,6	-2,0	-1,5
Agricultural production prices	2,6	22,5	21,8	22,1	12,5	4,9	-12,1	-7,8	-8,6	-6,3	-8,9	-10,7	-8,8	-5,4	-1,1	6,2	-0,5	0,3	-0,5	-1,0	-0,4	-
Competitiveness 10/																						
based on manufacturing prices	-0,1	-5,3	6,0	-7,8	-8,7	-8,9	-7,6	-7,6	-7,6	-8,0	-7,6	-6,8	-6,1	-5,7	-5,7	-2,9	-2,1	-1,8	-1,3	-1,0	0,1	-
based on CPI	-1,7	-1,6	-3,4	-5,3	-6,7	-7,6	-11,2	-11,4	-11,2	-11,5	-11,2	-10,5	-9,8	-9,2	-9,1	-6,4	-5,4	-5,4	-5,0	-4,9	-3,9	-
based on ULC (value added)	2,5	0,7	-2,4	-4,2	-6,1	-7,9	-	-	-13,7	-	-	-13,0	.	-11,7	-11,3	.	.	-8,0	.	.	.	.

Table 2.

ECONOMIC INDICATORS
Income and Monetary Aggregates

change from the same period of the previous year, %

		1999	2000.	2001				2002									2003						
		I-IV. quarter	I-IV. quarter	I. quarter	I. half of year	I-III. quarter	I-IV. quarter	1. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month	I-III. quarter	I-IV. quarter	1. month	1 - 2 month	I. quarter	1 - 4 month	1 - 5 month	I. half of year	1 - 7 month
Average earnings:	gross	16,1	13,5	16,5	17,1	17,0	18,0	19,4	19,3	19,4	18,3	18,6	18,3	18,2	18,4	18,3	20,9	17,1	15,2	14,8	14,3	14,1	-
	net	12,7	11,4	15,1	15,5	15,4	16,2	18,8	18,6	18,7	17,9	18,2	18,0	17,9	18,6	19,6	23,1	20,5	18,9	18,5	18,1	18,1	-
Household	savings (HUF billion)	870,9	1049,9	163,5	421,2	702,7	1145,4	-	-	179,9	-	-	427,5	-	710,5	1196,8	-	-	185,7	-	-	-	-
	credits (HUF billion)	121,0	245,4	66,9	172,2	280,5	391,8	-	-	92,6	-	-	292,9	-	545,0	768,3	-	-	193,6	-	-	-	-
General government GFS balance (HUF million) 4/		-424,1	-480,2	-58,5	-145,9	-235,1	-444,0	-75,3	-180,7	-242,9	-316,3	-409,2	-501,4	-497,6	-756,3	-1685,6	-44,4	-208,2	-282,1	-400,4	-408,7	-601,1	-601,9
Central budget	GFS balance (HUF billion) 4/	-338,1	-368,7	-35,2	-84,2	-170,6	-402,9	-59,3	-143,1	-186,9	-240,2	-280,2	-359,6	-343,5	-507,4	-1469,6	-12,9	-140,8	-224,1	-275,6	-252,9	-458,6	-424,8
	primary balance (HUF billion)	414,1	329,7	137,0	241,0	291,7	212,7	-16,3	-50,5	-29,7	-12,5	9,3	-7,9	48,8	-16,1	-832,0	23,3	-31,5	-70,3	-39,2	27,3	-89,5	-14,3
	revenue change 4/	22,5	14,2	14,8	10,4	8,6	10,5	3,7	8,0	5,8	8,7	9,8	7,4	8,8	8,0	7,1	23,9	14,1	10,0	11,5	12,6	11,3	12,5
	expenditure change 4/	12,3	13,7	3,5	5,4	7,9	10,4	22,8	24,3	20,9	22,5	22,7	21,2	18,9	18,8	30,4	10,5	11,3	11,6	12,0	9,5	13,7	13,9
Social Security Funds 5/: balance		-46,6	-81,4	-33,3	-70,8	-81,9	-28,8	-17,5	-45,6	-63,4	-83,7	-136,2	-146,9	-166,9	-256,6	-100,9	-42,1	-87,8	-79,4	-147,6	-180,9	-169,4	-211,7
	revenue change	15,4	10,7	14,1	14,6	15,3	18,6	13,0	13,2	11,0	11,5	11,0	10,8	9,4	10,4	17,2	13,0	12,8	20,5	16,3	14,5	16,7	15,2
	expenditure change	11,7	12,5	14,2	16,4	15,0	14,9	15,5	16,0	16,1	16,6	20,0	17,5	21,8	21,2	20,4	23,6	21,9	21,0	22,7	17,0	16,5	16,6
Government paper benchmark yielos (average annual) 6/																							
	3 month	12,87	11,80	10,99	10,76	10,77	9,80	9,03	8,42	8,38	8,39	8,57	8,90	9,31	9,53	8,24	6,75	5,48	6,27	6,38	6,37	7,63	9,57
	12 month	12,92	11,57	10,77	10,30	10,34	9,21	8,46	8,14	8,31	8,34	8,81	8,82	9,75	9,67	7,95	6,51	6,20	6,58	6,46	6,31	8,12	8,97
	3 year-bonds	10,89	10,74	9,77	8,60	9,28	8,17	7,33	7,52	7,84	7,85	8,40	8,90	9,37	9,29	7,37	6,88	6,84	6,64	6,50	6,29	7,86	8,47
	5 year-bonds	10,30	9,11	9,59	8,23	8,77	7,72	6,87	7,15	7,42	7,40	8,07	7,98	8,60	8,47	7,00	6,74	6,54	6,74	6,36	5,98	6,51	7,49
	10 year-bonds	-	9,04	-	-	8,18	7,06	6,64	6,88	-	6,85	6,88	7,79	7,65	7,34	6,44	6,51	6,42	6,50	6,31	5,95	6,08	6,75
	15 year-bonds						6,68	-	-	6,83	-	7,14	-	-	-	-	6,34	-	6,34	6,23	-	6,51	-
Interest rates 6, 7/:																							
with maturity less than a year	credit	15,4	12,80	12,40	12,08	12,04	11,18	10,4	10,0	9,7	9,7	9,9	10,1	10,5	10,7	9,7	8,3	7,0	8,2	8,2	8,0	8,7	10,7
	deposit	12,8	9,50	9,30	9,00	9,05	8,40	7,7	7,1	7,0	6,9	6,9	7,0	7,3	7,5	7,4	5,5	3,9	5,1	5,4	5,4	6,6	8,0
with maturity more than a year	credit	15,8	13,40	12,90	12,50	12,49	11,15	10,5	10,2	9,5	10,2	10,4	10,5	10,6	10,9	9,7	9,5	9,7	9,4	8,1	7,8	9,5	8,8
	deposit	13,0	9,40	9,00	8,90	8,89	7,70	7,4	6,6	5,4	6,0	6,4	7,0	8,4	7,2	8,0	5,1	4,7	5,1	5,4	5,3	6,8	8,5
Increase of money supply 8/		15,9	12,9	12,2	12,6	15,1	17,2	16,9	15,9	16,1	17,7	16,4	17,1	17,1	14,4	18,9	10,9	13,0	12,9	12,1	13,5	14,8	15,5
Current account of balance of payments (mEUR) new methodology		-2301	-3152	-684	-1692	-1473	-1967	-261	-438	-480	-820	-944	-1205	-1459	-1491	-2771	-200	-626	-849	-1441	-1746	-	-
Net foreign debt denominated in foreing currencies (bEUR) new meth. 9/		5,7	7,0	6,4	5,9	5,5	4,3	5,0	4,9	4,8	4,7	4,6	5,2	5,2	4,4	4,2	-	-	5,0	-	-	-	-
BUX index 3/		8819	7865	6653	6728	6174	7122	8108	7942	8113	8674	8115	7253	7049	7102	7739	7486	7212	7423	8116	8337	7782	8288

METHODOLOGICAL REMARKS

for Table 1 and 2

Signs: * Preliminary data; **.** : data is not available yet; **-** : no data for the period

1/ Including industrial customs free zones. The Statistical Office price indexes are published quarterly; the volumes for other periods are calculated with estimated price indexes.

2/ Data for firms with more than 5 employees and for budgetary institutions total.

3/ End of period data.

4/ Excluding privatization receipts. At the general government the interim data do not include the local governments.

5/ Total revenues and expenditures of the Pension Fund and Health Fund are not consolidated with the non-self-provided services.

6/ The yield or interest in the last month of the period.

7/ At deposits with maturity longer than a month but not longer than a year.

8/ M3 does not include deposits with an agreed maturity over 2 years and debt securities with over 2 years' agreed maturity issued by motetary financial institutions. However, it includes holdings by residents other than monetary financial institutions of MNB bonds with up to 2 years' agreed maturity plus holdings by residents other than monetary financial institutions of investment units issued by money market funds.

9/ Excluding intercompany loans

10/ Price based indicators seasonally non-adjusted, unit labour cost based indicators seasonally adjusted

11/ As a consequence of correction of short term credits the net foreign debt has changed.

12/ There is a change in the statistical methodology from December 2002, therefore the CSO corrected only the annual volume indices. According to the CSO publication exports went up by 5,9 % while imports increased by 5,1 % in 2002.

13/ Without part-time employees

14/Including sales of motor vehicles and antomative fuel

Table 3.

Main Indicators of the Hungarian Economy

2001 - 2003

	2001 fact	2002 prel.fact	2003 expected
	volume change over the previous year,%		
Gross Domestic Product	3,8	3,3	3 - 3,5
Domestic use of G D P	1,9	5,1	cca. 5,5
of which:household consumption	5,3	8,8	7 - 8
gross fixed capital formation	3,5	5,8	3 - 4
Foreign trade turnover (goods and services)			
Export volume change	8,8	3,8	3 - 5
Import volume change	6,1	6,1	6 - 8
	change in percentage of previous year		
Gross average wages	18	18,3	11 - 12
Net average wages	16,2	19,6	16 - 17
Real wages, per employees	6,4	13,6	10 - 12
Consumer price index (annual average)	9,2	5,3	4,8 - 5
	at current prices		
Deficit of foreign trade balance, Euro billion	3,6	3,4	4,5 - 5
Current account deficit, Euro billion	2,0	2,8	4 - 4,2
	in percentage of GDP		
Indicators in percentage of GDP:			
ESA95 general government deficit	4,7	cca. 9,2	cca. 4,8
Current account deficit	3,4	4,0	cca. 5,5

Table 4.

GROWTH RATES AND GROWTH PROJECTIONS ON THE WORLD ECONOMY

Percentage change in real GDP realtive to the preceding relevant period

Denomination	2 0 0 1 Q1	Q2 (Economist)	Q3	Q4	2 0 0 1	2 0 0 2 Q1	Q2 (Economist)	Q3	Q4	2002 (estimate)	2003 Q1 (Economist)	Q2	2 0 0 3 (estimate) (Economist)	2004 (projection) (Economist)
United States	2,5	1,2	0,6	0,5	0,3	1,5	2,2	3,2	2,9	2,4	2,0	2,3	2,3	3,4
Japan	-0,1	-0,7	-0,5	-1,9	0,4	-1,6	-0,7	1,3	2,6	0,3	2,6	2,1	0,9	0,9
Eurozone	2,5	1,7	1,3	0,6	1,5	0,3	0,7	0,8	1,2	0,8	0,8	0,4	0,6	1,7
Germany	1,6	0,6	0,3	-0,1	0,6	-0,2	0,1	0,4	0,5	0,2	0,2	-0,2	0,0	1,2
France	2,7	2,3	2,0	0,9	1,8	0,7	1,2	1,2	1,7	1,2	1,1	0,0	0,8	1,9
Italy	2,3	2,0	1,9	0,7	1,8	0,1	0,2	0,5	1,0	0,4	0,8	0,3	0,5	1,5
United Kingdom	2,6	2,3	2,1	1,6	1,9	1,0	1,3	1,8	2,1	1,8	2,2	1,8	1,8	2,4
Austria	2,2	1,2	0,9	-0,4	1,0	-0,6	0,9	1,2	1,3	1,0	1,0	n.a.	0,5	1,3
Poland	2,3	0,9	0,8	0,3	1,0	0,5	0,8	1,6	2,1	1,3	2,2	n.a.	2,9	4,1
Czech Republic	3,8	3,9	3,2	3,2	3,3	2,5	2,5	1,5	1,5	2,0	2,2	2,3	1,7	2,6
Russia	4,0	4,0	4,9	4,3	5,0	3,7	4,1	4,3	5,2	4,3	6,8	n.a.	6,0	5,0

Source: OECD, EU Commission, IMF, Economist